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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

A. Bates Butler, as Trustee
of Construction Materials Co.,
Appellant,

vs.

City of Tucson, et. al.,
Appellees.

The Bank of Tucson,
Appellant,

vs.

Pacific National Insurance Company,
City of Tucson, Martin Construction
Company and A. Bates Butler,
Appellees

No. 20390

Martin Construction Co. and
Pacific National Insurance Co.,
Appellants

vs.

Bank of Tucson, et al.,
Appellees.

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF ARIZONA

BRIEF FOR APPELLANT A. BATES BUTLER

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Tucson, Arizona

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ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
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BRIEF FOR APPELLANT A. BATES BUTLER

JURISDICTIONAL STATEMENT

This is an appeal from a judgment entered on the 26th day of May, 1965, by the United States District Court for the District of Arizona.

This appeal is brought under the jurisdiction established in Section 24 of the Bankruptcy Act, 11 U.S.C.A. Section 47.

INTRODUCTION

For the sake of clarity, A. BATES BUTLER, Trustee in Bankruptcy of Construction Materials Company, Bankrupt, Appellant, shall hereinafter be referred to as "Trustee." CONSTRUCTION MATERIALS COMPANY, bankrupt, will hereinafter be referred to as "Bankrupt." The CITY OF TUCSON, Appellee, will hereinafter be referred to as "City." THE BANK OF TUCSON, Appellee, shall hereinafter be referred to as "Bank," and MARTIN CONSTRUCTION COMPANY, Appellee, shall hereinafter be referred to as "Martin."

The Appellant after thorough research has come to the conclusion that the Statement of Points that Appellant intends to rely upon under Counts I and II of the Complaint should be abandoned and therefore this brief will contain no questions or argument as to the points contained in Count I and II and this brief will be limited to the Question presented under Count III of the Complaint.

STATEMENT OF THE CASE

This case is concerned with whether or not the Trustee has title to certain bonds under Section 70(a) of the Bankruptcy Act, or whether Martin has an equitable lien upon such bonds pursuant to Conclusion of Law Numbers 12 and 13.

It is the contention of the Trustee that Martin does not have an equitable lien under the laws of the State of Arizona.

The Trustee instituted this action seeking to recover preferences accorded in violation of Sections 60 and 70 of the Bankruptcy Act.

FACTS OF THE CASE

Construction, a corporation, and the City entered into an agreement called the El Campo Estates Addition Paving Improvement Construction Contract (Joint Exhibit 1), on or about the 10th day of September, 1962.

On or about the 22nd day of October, 1962, Construction assigned to First Municipal Investments of Arizona, Inc., all of its right, title and interest in and to the El Campo District Contract, together with all diagrams, warrants, assessments, monies, bonds and payments of every kind and nature due or to become due or thereafter issued or paid, under or pursuant to the aforesaid contract. (The assignment is Joint Exhibit 2).

On or about the 8th day of May, 1963, Construction and Martin executed a letter agreement (Joint Exhibit 32) wherein Construction agreed to assign approximately $68,754.42 of certain bonds which are created pursuant to Arizona Revised Statutes Title 9, Chap. 6 authorizing the creation of improvement districts.

On or about September 6, 1963, Martin notified the City by letter (Joint Exhibit 21) that it claimed $68,754.42 in the amount of bonds to be issued in connection with the aforesaid contract.

On November 22, 1963, a petition for relief under Chapter XI of the Bankruptcy Act was filed voluntarily by Construction.

SPECIFICATION OF ERROR RELIED UPON

The District Court erred in Conclusions of Law Numbers 12 and 13. These conclusions found that Martin has an equitable lien against the bonds described in Finding of Fact Number 21, and that Martin is entitled to receive and apply to the payment of the sum due to it as found in Findings of Fact Number 14 such Wilmot District Improvement Bonds as remain in the registry of the District Court after delivery to Bank of the amount thereof to which the Bank is entitled by virtue of Conclusion of Law Number 11. The Court erred in not finding that the Trustee has full legal and equitable title to the bonds in question.

QUESTION PRESENTED

Is an agreement to assign certain contractual rights sufficient to create an equitable lien upon such contractual rights?

ARGUMENT

The Trustee's position is that a preferential payment to Martin has been authorized by the District Court's failure to uphold the Trustee's rights under Section 70(a) of the Bankruptcy Act.

As to what law governs the question of equitable liens, it is the Trustee's position that the Court must look to the applicable state law. *Erie R.R. v. Tompkins* (1938), 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188.

Arizona has discussed the creation of an equitable lien in two early cases: *Stephen v. Patterson* (1920), 21 Ariz. 308, 188 Pac. 131, and *Moeur v. Farm Builders Corp.* (1929), 35 Ariz. 130, 274 Pac. 1043. The *Stephen* case stated, at 21 Ariz. 311, 188 Pac. 132:

"We recognize the well-settled and familiar principle in equity that where it is clearly shown that the intention of the parties to a transaction is to give security for a debt or obligation upon some particular property, however informally such intention may be expressed, equity will in an appropriate proceeding declare an equity mortgage or lien to exist, and by its decree enforce the same as against such property in satisfaction of the debt of obligation."

In the *Stephen* case, the language creating the equitable lien was clear, to wit: ". . . and a special lien is created hereby on such property to secure the payment of this obligation." (21 Ariz. 309, 188 Pac. at 132). The intention of the parties in the *Stephen* case was not hard to determine.

The *Moeur* case, supra, cited the language from the *Stephen* case as set forth above, and went further in stating, at 35 Ariz. 138, 274 Pac. 1045:

"It is the law that a promise or agreement to pay out of a particular fund does not give to the promisee an equitable assignment or a lien upon such fund, or the property from which the fund is obtained."

Jones, Liens, 3d. Edition, Vol. 1, § 50:

"To constitute an equitable lien on a fund, there must be some distinct appropriation of the fund by the debtor, such an assignment or order that the creditor should be paid out of it. It is not enough that the fund may have been created through the efforts and outlays of the party claiming the lien. It is not enough that a debtor authorizes a third person to receive a fund and to pay it over to a creditor."

In other words, there must be something more than a mere promise to assign a fund. Jones goes on to say:

"An agreement between a debtor and creditor that the debt owing shall be paid out of a specific fund coming to the debtor, or an order given by a debtor to his creditor upon a person owing money or holding funds belonging to the giver of the order, directing such person to pay such funds to the creditor, will create a valid equitable charge upon such fund . . . ."

In the case of *Wilson v. Poland* (Tex., 1929), 14 S.W.2d 890, the issue of equitable assignment was brought before the court by a father whose son had transferred a claim to the father in writing and by word of mouth. The party to be charged was notified of this assignment. The Texas court stated that the appellant had rested under the burden of showing:

a) That his son had made to him for his use an absolute appropriation of the Wilson claim.

b) That the assignment was of the whole of the claim or of specific sum or fixed percentage thereof.

c) That his son had parted with all control over the claim.

The court then stated that there was no absolute appropriation; no fixed sum or percentage was designated, nor did the son part with control of the claim, but continued trying to collect it. (The son hired an attorney for the purpose of collection and had a suit instituted thereon in his own name, wherein he asserted ownership in himself.)

The *Moeur* case, supra, further held that the burden of proof is on the person claiming an equitable lien to show the existence of the agreement for the alleged equitable lien by a preponderance of the evidence.

In the present case, the assignment was made only by Exhibit 32, dated May 8, 1963, to wit:

"Construction Materials Company agrees to assign approximately $68,754.42 of the bonds on this project to Martin Construction Company."

Neither in the Martin notice, Exhibit 21, nor in the affidavit, Exhibit 30, has there ever been any mention of an assignment — nor was such ever alluded to during the trial of the case. Martin's demand has never been based upon an assignment; Martin claims merely as a subcontractor. (Exhibit 21)

Therefore, applying the law as set forth to Martin's situation herein, it is not possible to sustain the conclusion that Martin has an equitable lien upon the balance of the bonds for the following reasons:

A) Martin has failed to sustain the burden of proof that there was or has been an assignment of anything by Construction.

B) The Martin claim is analogous to the foregoing *Wilson* case

1) There has never been an absolute appropriation of the claim by Martin.

2) There was not an assignment of the whole or the balance due after the Bank was paid.

3) There was no assignment of a specific sum.

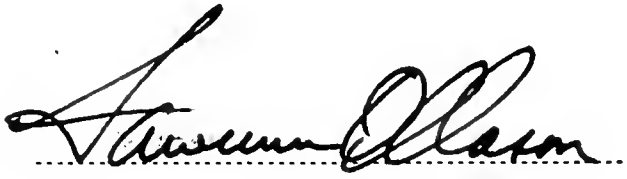
4) Construction did not part with control of the warrant; rather it attempted collection.

5) Martin filed a demand upon the City on the basis of certain Arizona Revised Statutes pertaining thereto, not on the basis of an assignment.

CONCLUSION

The only grounds upon which Martin can base any claim of an assignment is a mere promise to assign and not an actual assignment. The most which the breach of this promise does is create an action in law for breach of contract. It is not sufficient to form the basis of an equitable lien. Further indication of the absence of an equitable lien here is that at no time was anything given to Martin that placed Martin in control of the bonds in question.

It is respectfully submitted that the judgment of the District Court be reversed and that title be held to have vested in the Trustee free and clear of any equitable lien of Martin.



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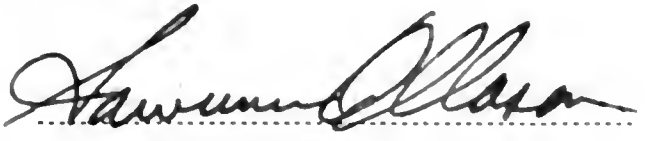
I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.



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ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT OF ARIZONA

ANSWERING BRIEF OF APPELLEE AND OPENING BRIEF OF CROSS-APPELLANT THE BANK OF TUCSON

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ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE DISTRICT OF ARIZONA

ANSWERING BRIEF OF APPELLEE AND OPENING BRIEF OF CROSS-APPELLANT THE BANK OF TUCSON

JURISDICTIONAL STATEMENT

This cross-appeal is brought from a judgment entered on the 26th day of May, 1965, by the United States District Court for the District of Arizona and is brought under the jurisdiction established by Rule 73, Federal Rules of Civil Procedure and 28 USC §1291.

INTRODUCTION

For clarity, THE BANK OF TUCSON, Appellee and Cross-Appellant, will hereinafter be referred to as Bank; MARTIN CONSTRUCTION COMPANY, Appellee and Cross-Appellant will hereinafter be referred to as Martin; PACIFIC NATIONAL INSURANCE CO., Appellee and Cross-Appellant will hereinafter be referred to as Pacific; and A. BATES BUTLER, Appellant and Cross-Appellee will hereinafter be referred to

as Trustee, who is the Trustee of Construction Materials Company, a corporation, now in bankruptcy, hereinafter referred to as Construction.

STATEMENT OF THE CASE

APPEAL OF TRUSTEE: The appeal perfected by the Trustee has apparently been abandoned as to this Appellee, The Bank of Tucson or its interests. Therefore, this brief will only briefly concern itself with the plaintiff's appeal.

CROSS-APPEAL OF THE BANK OF TUCSON: This case is only concerned as far as the cross-appeal of this Cross-Appellant is concerned, as to whether or not the Bank was entitled to receive as its attorneys' fees the ten (10%) per cent amount specified in a promissory note, in addition to the sums of principal and interest due thereunder which were awarded to

it, and whether the last sentence of Findings of Fact No. 25 herein, is contrary to the evidence when the reasonableness of the fees was not put in issue nor any evidence introduced thereon.

It is the contention of the Bank that in addition to the amount of the principal and interest due upon said promissory note, it was entitled to receive the amount specified therein as and for its attorneys' fees.

By stipulation and order the Appellees and Cross-Appellants have combined their answering briefs on appeal and their opening appeal briefs on the cross-appeals.

FACTS OF THE CASE

Construction entered into two (2) improvement construction contracts with

the City. The first was called the El Campo Estates Additional Paving Improvement Construction Contract. The second was known as the Wilmot Road, Broadway to Speedway, Paving and Drainage Structure District Contract, hereinafter referred to as the Wilmot Road Contract, the proceeds of which were thereafter assigned by Construction to the Bank by Joint Exhibit 20 to secure payment of Construction's promissory note to the Bank. (Joint Exhibit 19) Thereafter, the Bank advanced various sums of money thereunder to Construction, and the Bank thereafter received cash collections to be applied against said note which reduced the principal balance due to the sum of $25,126.69 together with interest thereon at the rate of six (6%) per cent per annum from December 12, 1963, which balance remained

due and owing until the entry of judgment herein. The promissory note which was placed in the hands of the Bank's attorneys for collection, Joint Exhibit 19, provides for attorneys' fees to be awarded to the Bank in the sum of ten (10%) per cent of the amount found to be due and owing thereon. Pursuant to Arizona Revised Statutes, Title 9, Chapter 6 and the terms of the Wilmot Road, Broadway to Speedway, Paving and Drainage Structure District Contract as the proceeds thereof the City issued non-negotiable improvement district bonds in the principal sum of $57,383.69, which all parties claimed and which were placed in the registry of the District Court pending the determination of the District Court in the proceedings out of which the instant appeals arose.

Of the non-negotiable bonds, the

Bank was awarded a sufficient amount to make the principal and interest then due on the promissory note of Construction (Joint Exhibit 19) pursuant to the assignment of the Wilmot Road, Broadway to Speedway, Paving and Drainage District Contract proceeds (Joint Exhibit 20), but was not awarded any portion of said bonds to make the amount of its attorneys' fees provided for in said promissory note nor was it awarded any sums as and for its attorneys' fees, contrary to the terms of said promissory note.

SPECIFICATION OF ERROR RELIED ON

The District Court erred in so much of Finding of Fact No. 25 as found that ten (10%) per cent of the amount found due from Construction to the Bank would be an unreasonable sum to be allowed to said defendant as attorneys'

fees in this case, and further erred in so much of Conclusions of Law No. 11 as fails to allow The Bank of Tucson, in addition to the sums of principal and interest due, then (10%) per cent of such amount as and for its attorneys' fees, and erred in not awarding the Bank any amount for attorneys' fees.

QUESTION PRESENTED

In the absence of a tender of issue thereon and an affirmative showing of unreasonableness, does the Court have the power to deny a stipulated amount or percentage for attorneys' fees in awarding a judgment on a negotiable instrument?

ARGUMENT

The Bank's position is that in the absence of a tender of issue of unreasonableness and proof thereof, a

stipulation for a stated per cent as attorneys' fees in a negotiable instrument is binding and must be honored.

This position is amply supported by 17 Am.Jur.2d, Contracts, §2294 which says:

> "A stipulation for attorneys fees is binding...."

and also by Bank of Commerce v. Fuqua, 11 Mont. 285, 28 P. 291; Franklin v. Duncan, 133 Tenn. 472, 182 S.W. 230 (noting validity and enforceability of stipulation for ten (10%) per cent attorneys' fees in a promissory note); and Downey v. Coolidge, 48 Wash.2d 45, 294 P.2d 926, 117 A.L.R. 1236.

17 Am.Jur.2d, Contracts, §352, further states as the rule:

> ".... a stipulation that a certain amount shall be collectible as attorneys fees controls recovery if the amount stipulated is reasonable .... ."

And,

> "If the maker or debtor has stipulated to pay a specified sum as attorneys fees and no issue is raised by him as to its reasonableness, the judgment in an action upon the instrument may properly include the amount so stipulated according to a number of cases. Thus, in such cases it is held that the burden is upon the debtor, and that in the absence of allegation or proof by him that the stipulated amount is unreasonable or that the creditor has incurred no expenses in the premises, the percentage provision will be enforced .... ."

This rule is supported by the cases of Taylor v. Continental Supply Co., CA 8 Colo. and 16 F.2d 578; Kuper v. Schmidt, 161 Tex. 189, 338 S.W.2d 948, which hold that, as stated in Taylor v. Continental Supply Co. (supra):

> "The amount in a note agreed on as attorneys fees is presumed to be a reasonable attorney's fees, and the burden is on defendant, when suit is brought on a note providing attorneys fees, to show that the amount fixed in the note is not such."

Squarely in point is Tsesmelis v. Sinton

State Bank, 53 S.W.2d 461, 85 A.L.R. 319, which holds that where the maker of a note agreed to pay attorneys' fees of ten (10%) per cent if placed in the hands of an attorney for collection, and no issue is made of the reasonableness of such fee, judgment in an action on note may properly include the amount so stipulated.

To the same effect are: Conway v. American National Bank, 146 Va. 357, 131 S.E. 803, and First National Bank v. Robinson, 135 S.W. 372.

As pointed out by Cross-Appellee, Trustee, in his opening brief, the law of the State of Arizona governs here, Erie Railroad v. Tompkins, 304 U.S. 64, 58 S.Ct. 817, 82 L.Ed. 1188; Adelman v. Centaur Corp., (CCA Ohio) 145 F.2d 573.

Turning then to the Arizona cases, we find that Arizona has adopted the

rule above set forth and supported.

The Supreme Court of Arizona in several cases, chiefly Pioneer Construction v. Symes', 77 Ariz. 107, 267 P.2d 740 and Mayo v. Ephrom, 84 Ariz. 169, 325 P.2d 814, has by necessary implication or assumption, adopted the rule that where a stipulated per cent of a note is provided as attorneys' fees, such amount will be awarded in the absence of an issue as to and a showing of the unreasonableness thereof. This it has done by holding that where suit is brought on such a note and there is a counterclaim on which judgment is also given, the amount thereof must be deducted from the amount found due on the promissory note before applying the stipulated per cent to determine the attorneys' fees to be awarded.

In further support of this

position, it is to be observed that the State of Arizona has adopted the Uniform Negotiable Instruments Act (Arizona Revised Statutes, 44-401, et seq). The adoption of this act is given great weight as an approval of the State Legislature of the percentage provision for attorneys' fees. 17 A.L.R.2d 297, §7.

In this case no issue was even raised as to the reasonableness of the attorneys' fees specified in the promissory note in evidence as Joint Exhibit 20 which provides for ten (10%) per cent of the amount found to be due on date of judgment as attorneys' fees. Further, there was absolutely no evidence of unreasonableness introduced. This, taken into account together with the Findings of Fact that there was due thereunder the sum of $25,169.26, together with interest at six (6%) per

cent per annum thereon to the date of judgment May 26, 1965, from November 11, 1963, establishes the exact amount of attorneys' fees to which the Bank is entitled, in addition to the sums of principal and interest awarded it.

Further as noted in 9 Am.Jur.2d, Bankruptcy, §962:

> "A secured obligation for the payment of attorneys' fees and necessary expenses of collection is one which survives bankruptcy."

Security and Mortgage Co. v. Powers, 278 U.S. 149, 73 L.Ed. 236, 49 S.Ct. 84, so there is no question as to the Bank's right to recover the stipulated attorneys' fees out of the proceeds of the Wilmot Road, Broadway to Speedway, Paving and Drainage Structure District Contract, the non-negotiable municipal bonds, as against a trustee in bankruptcy.

As Judge Sanborn said in Cleo Syrup Corp. v. Coca Cola Co., (CA 8) 139 F.2d 416, cert. den., 321 U.S. 78, Findings of Fact of the District Court will only be set aside where there is no substantial evidence to support it, or where induced by an erroneous view of the law (citing cases). This is the law and needs no further elaboration. In this case there is not only no substantial evidence to support that part of Finding of Fact No. 25 which finds that ten (10%) per cent of the amount found to be due on the note ($25,126.69 plus interest at six (6%) per cent per annum from December 11, 1963 to May 26, 1965) would be an unreasonable attorney's fee, but there was no evidence whatever to support it. As previously noted it must have been induced by an erroneous view of the law.

For the foregoing reasons, the

judgment entered herein should be reversed as to the finding of unreasonableness as attorneys' fees to the Bank of ten (10%) per cent of the amount found to be due on the promissory note, with instructions to enter judgment in favor of the Bank for that sum in addition to the sums previously awarded as principal and interest.

Turning then briefly to the Trustee's appeal, it appears that the Trustee has abandoned his appeal as it relates to the Bank of Tucson and conceded thereby the Bank's position.

In the introduction to his brief, Appellant, Trustee, states that after thorough research he has abandoned the points he had intended to rely on under Counts One and Two of his complaint and will solely present argument as to the questions presented under Count Three.

He then, on Page 2 of Appellant's brief, under the heading Statement of the Case, says:

> "This case is concerned with whether or not the Trustee has title to certain bonds under Section 70(a) of the Bankruptcy Act, or whether Martin has an equitable lien upon such bonds pursuant to Conclusion of Law Numbers 12 and 13."

The named Conclusions deal with an equitable lien of Martin on the bonds and do not concern the Bank, which was, under Conclusion No. 11 (not assigned as error) awarded sufficient of the bonds to make the principal and interest due it as a prior claim to that of the lien of Martin set forth in Conclusions No. 12 and 13. The abandonment of the appeal as to the Bank is further clarified by the Trustee on Page 4 of his opening brief under the headings Specification of Error Relied

Upon and Question Presented, in which he states that the question presented is:

> "Is an Agreement to assign certain contractual rights sufficient to create an equitable lien on such contractual rights."

This, of course, does not in any way affect the interest of the Bank nor the judgment entered in its favor as it deals solely, as do the specifications of error relied upon, with the rights of Martin and the Trustee as to the bonds remaining after the Bank of Tucson has taken sufficient thereof to make its principal and interest due. Further, the Trustee's argument presented on Pages 4 through 8 of his brief deals solely with the question of whether or not Martin has an equitable lien by reason of its agreement to assign the balance of the bonds after the Bank has

taken its share or whether the balance thereof belongs to the Trustee.

It may also be noted that the same rules are applicable to the Bank and the Trustee in Count Three as in Counts One and Two. If the assignments were good, as against the Trustee with respect to the matters set forth in Counts One and Two, as Trustee now concedes, then it is also good as against him as to his claims under Count Three as the assignment is the same one concerned with in Count Two and the subject matter - i.e., the Wilmot Road Contract proceeds are also the same. In fact, as above noted it appears that Trustee also concedes this and is limiting this appeal to the question of the respective rights of Trustee and Martin to the balance or residue of the improvement district bonds

after the Bank's claim is satisfied.

For the foregoing reasons, this Appellee will present only the following very limited brief with regard to its right to sufficient of the subject bonds to make the amount of principal and interest found due it in the event any question is raised by the Appellant Trustee in his Reply Brief in relation thereto.

As is noted in the Statement of the Case, Construction entered into the Wilmot Road Contract and promptly assigned the proceeds by Joint Exhibit 20 to the Bank to secure Construction's promissory note to the Bank (Joint Exhibit 19) (Stipulated Facts, pp. 4 and 5). Thereafter, the Bank received collections under the assignment sufficient to reduce the principal balance to

$25,126.69 plus interest and attorneys' fees as provided in the note, at which time improvement District bonds were issued by the City of Tucson.

If the Appellant Trustee desires to raise the question as to the respective rights of Trustee and the Bank as against these bonds, it is to be first noted that the bonds are non-negotiable as each provides, as required by Arizona Revised Statutes 9-695, that it:

> ".... is payable only out of the special funds to be collected from special assessments imposed on the lots or parcel of land fronted on or benefited from said improvement." (Finding of Fact No. 21)

Therefore, by the terms of Arizona Revised Statutes, 44-401 and 403, these bonds are non-negotiable. Section 401 provides as follows:

> "An instrument to be negotiable must conform to the following requirements ....

> "Must contain an unconditional promise or order to pay a sum certain .... ."

And Section 403 provides, in Subsection B thereof:

> "But an order or promise to pay only out of a particular fund is not negotiable."

Therefore, the bonds are obviously not negotiable, being payable only out of a particular fund. Moore v. Nampa, 276 U.S. 536; Northern Trust Co. v. Wilmette, 77 N.E. 169; Manker v. American Savings Bank and Trust Co., 230 P. 406, 42 A.L.R. 1021; Washington County v. William, (CA 8) Neb., 111 F. 801.

Also an examination of the assignment, Joint Exhibit 20, reveals that it is an assignment of the right to receive the proceeds of the Wilmot Construction Contract and there is no doubt that the right to receive such proceeds is chose in action which can be validly presently

assigned. Kuhnen v. National Bank of Liberty, 187 N.Y.2d 598; Costello v. Bank of America National Trust and Savings Association, (CA 9) 246 F.2d 807 and Restatement of Law of Contracts, §149 and §154.

Therefore, the bonds in question, being the proceeds of the Wilmot Construction Contract, having been assigned many months prior to bankruptcy and the assignment having been served upon the City of Tucson and accepted by it (Stipulation of Facts, p. 5), the assignment was valid as against the Trustee in Bankruptcy and the other parties even though service of the assignment on the individual property owners was not made until later as such service is not necessary. Smith v. Harris, 278 P.2d 835, 6 Am.Jur.2d, Assignments, §97; Cincinnati Iron Store

Co., (CA 6 Ohio) 167 F. 46; Robertson v. Hennochsberg, 1 F.2d 604; Walton v. Horkan, 814 S.E. 105; Jennings v. Whitney, 112 N.E. 665; Pillsbury Investment Co. v. Otto, 65 N.W.2d 914; Joyce-Pruitt Co. v. Meadows, 244 P. 889; Moore v. Schenck, 3 Hill (N.Y.) 228; Campbell v. J. E. Grant Co., 82 S.W. 794; Goodwin v. Barre Savings Bank and Trust Co., 100 Alt. 34; Stansberry v. Meadow Land Dairy, 105 P.2d 86; Greery v. Dockendorf, 231 U.S. 513.

Further the chose in action involved here was assignable, for, as noted in the cases of Commercial Life Insurance Company v. Wright and Employers Casualty Co. v. Moore, 166 P.2d 943 and 143 P.2d 414, respectively, by the Supreme Court of Arizona, quoting Volume I, Restatement of Law of Contracts, Sec. 154:

> "Except as stated in Sec. 151, a right expected to arise in the future under a contract of employment in existence at the time of the assignment may be effectively assigned."

The exceptions set forth in Sec. 151 thereof, of course, are not applicable to this action and the Stipulation of Facts, pages 4 and 5, shows that the Wilmot Contract, the proceeds of which were assigned, was in fact in existence at the time of the assignment.

The Supreme Court of Arizona in Employment Casualty Co. v. Moore (supra) further said:

> "The test as to assignability of a chose is whether it will survive and pass to the personal representative. If it will survive, it can be assigned."

Arizona Revised Statutes 14-477 provides that in Arizona all causes survive with exception of those specifically set forth therein, such as

breach of promise to marry, seduction, liable, slander, separate maintenance, alimony, loss of consortium, or invasion of the right of privacy, none of which are applicable to this action. Therefore, the choses here involved were assignable and, in fact, assigned.

CONCLUSION

As first noted, the Trustee apparently has abandoned his appeal as to all points affecting the judgment entered in favor of this Appellee, The Bank of Tucson, and acknowledges that the Bank's position is correct. In addition, the above-cited authorities establish that the contract proceeds of the Wilmot Contract, to-wit, the non-negotiable bonds, were, in fact, assigned prior to bankruptcy and that such assignment was valid as against

the trustee and the other parties. Therefore, the Bank was entitled to receive the balance of the principal and interest due pursuant to the promissory note as against all other parties.

In addition to the principal and interest, the Bank was also entitled to have the stipulated percentage of the amounts found to be due under the promissory note as and for its attorneys fees as the other parties to the action failed to place the unreasonableness of the amount thereof, in issue, or to introduce any evidence whatsoever on the matter.

It is therefore respectfully submitted that the judgment of the District Court should be upheld in its entirety, with the exception that it should be reversed as to the question of the allowance of the Bank of Tucson's attorneys'

fees as specified in the promissory note of Construction, and the Bank be given judgment for its attorneys' fees as a prior claim to all of the parties in and to the balance of the remainder of the bonds.

DONALD S. ROBINSON
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Tucson, Arizona
Attorney for Appellee

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

DONALD S. ROBINSON
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Tucson, Arizona
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IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

A. Bates Butler, as Trustee
of Construction Materials Co.,
Appellant,

vs.

City of Tucson, et. al.,
Appellees.

The Bank of Tucson,
Appellant,

vs.

Pacific National Insurance Company,
City of Tucson, Martin Construction
Company and A. Bates Butler,
Appellees

No. 20390

Martin Construction Co. and
Pacific National Insurance Co.,
Appellants

vs.

Bank of Tucson, et al.,
Appellees.

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF ARIZONA

BRIEF FOR APPELLEE CITY OF TUCSON

JAY M. ABBEY
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Tucson, Arizona

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IN THE

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A. Bates Butler, as Trustee
of Construction Materials Co.,
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ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
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BRIEF FOR APPELLEE CITY OF TUCSON

JURISDICTIONAL STATEMENT

Appellee City concurs with Appellant Trustees jurisdictional statement.

INTRODUCTION

For the purposes of this brief, the parties will be designated as they are in Appellant A. Bates Butler's brief, that is, A. BATES BUTLER, Trustee in Bankruptcy of Construction Materials Company, Bankrupt, Appellant, shall hereinafter be referred to as "Trustee". CONSTRUCTION MATERIALS COMPANY, bankrupt, will hereinafter be referred to as "Bankrupt". The CITY OF TUCSON, Appellee, will hereinafter be referred to as "City". THE BANK OF TUCSON, Appellee, shall hereinafter be referred to as "Bank", and MARTIN CONSTRUCTION COMPANY, Appellee, shall hereinafter be referred to as "Martin".

STATEMENT OF THE CASE

Since Appellant has apparently abandoned any designated grounds of appeal which would bear directly upon the City of Tucson, the City will concern itself only as a nominal party to the appeal, and make an effort towards brevity.

FACTS OF THE CASE

The facts as set forth by the Appellee and the Bank are properly stated and the City would therefore respectfully ask leave of the Court to adopt those facts. The City would also like to clarify the point as to the bonds in issue being placed in the registry of the Court. As shown by City's Answer in the District Court, the City claimed no interest in the bonds in issue and re-

quested the Court to take jurisdiction of the bonds and to determine in the action to whom they should be delivered. Subsequently, these bonds were delivered to the Clerk of the Court and their disposition was adjudicated.

QUESTION PRESENTED

No question is presented by the City.

ARGUMENT

The City, not having opposed the position of any of the parties in the trial as to Count III of the Complaint, cannot now change position and argue as to the disposition of the bonds. The City feels that the ruling of the Court was the result of proper consideration of the law and facts in the matter.

CONCLUSION

Because of its position, which is in the nature of interpleader, the City seeks only a final adjudication as to the disposition of the bonds in question.

JAY M. ABBEY
ASSISTANT CITY ATTORNEY
109 North Meyer Avenue
Tucson, Arizona

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAY M. ABBEY
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109 North Meyer Avenue
Tucson, Arizona

No. 20390

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

A. BATES BUTLER, as Trustee of CONSTRUCTION MATERIALS CO.,

Appellant,

vs.

CITY OF TUCSON, et al.,

Appellees.

MARTIN CONSTRUCTION CO. and PACIFIC NATIONAL INSURANCE CO.,

Appellants,

vs.

BANK OF TUCSON, et al.,

Appellees.

On Appeal from The United States
District Court for the District of Arizona

ANSWERING BRIEF ON CROSS-APPEAL

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No. 20390

IN THE

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

MARTIN CONSTRUCTION CO. and PACIFIC NATIONAL INSURANCE CO.,	)
Appellants,	)
vs.	)
BANK OF TUCSON, et al.,	)
Appellees.	)

On Appeal from The United States District Court for the District of Arizona

ANSWERING BRIEF ON CROSS-APPEAL

As in prior briefs, Appellant, A. BATES BUTLER, Trustee in Bankruptcy of Construction Materials Co., Bankrupt, is referred to as "Trustee"; CONSTRUCTION MATERIALS COMPANY, as "Construction";

CITY OF TUCSON, as "City"; THE BANK OF TUCSON, as "Bank"; MARTIN CONSTRUCTION COMPANY, as "Martin", and PACIFIC NATIONAL INSURANCE COMPANY, as "Pacific".

Most of the ultimate facts in the trial court were undisputed, and were made part of the record by a written Stipulation of Facts filed December 7, 1964, which stipulation is listed as document No. 28 in the Clerk's Certificate of Record on Appeal. This document is cited hereinafter as "Stipulation."

SUPPLEMENTAL STATEMENT OF CASE

As cross-appellants note, we are concerned on this cross-appeal with the disposition of certain improvement district bonds which were deposited in the registry of the Court by City and which were issued in relation to an

improvement district contract known as the Wilmot Improvement District Contract entered into by Construction and City March 26, 1963. On the same date, Construction assigned all the proceeds of the Wilmot Improvement District Contract to Bank (Assignment in evidence as Joint Exhibit 20) to secure the payment of Construction's promissory note to Bank (Joint Exhibit 19), and said assignment was accepted by City March 28, 1963 (Stipulation, page 5). At the time of the trial there was a balance due on said promissory note (Joint Exhibit 19) of $25,169.26, together with interest thereon at the rate of 6% from December 12, 1963 to date of entry of judgment herein (Finding of Fact No. 25 and Joint Exhibit 19). The question of the allowance of Bank's attorney's fees is the subject of Bank's separate

cross-appeal herein. The warrant and assessments on the Wilmot Improvement District Contract described and provided for in Arizona Revised Statutes, Sections 9-683 (e) and 9-686, were duly issued by the Superintendent of Streets of City on or before November 19, 1963 (Stipulation). Thereafter, on December 16, 1963, by Resolution No. 5664, the City approved the assessment and proceeding on the Wilmot Improvement District Contract (Stipulation, page 7). At trial, the issues as between Bank and Pacific were severed for later trial (Transcript of Proceedings of December 11, 1964).

ARGUMENT

As noted in the Supplemental Statement of Facts, at the trial of the main claims herein, the issues as between

Pacific and Bank were severed for later determination. The subject of the issues between Pacific and the Bank concerns defendant Bank's Exhibit A, which was designated as a part of Item No. 32 on the Clerk's Certificate of Record on Appeal, a purported surety bond. Among other things, said surety bond provides that:

> "The surety (Pacific) consents to the assignment of said improvement district contract and the proceeds thereof to the obligee (Bank) and recognizes the obligee's right to receive all payments whether in money, warrants, assessments or bonds, accruing on said improvement contract. The surety agrees that the obligee's right to receive such proceeds shall have priority ....",

thereby subrogating Pacific's rights to that of the Bank. Pacific resists this surety bond contending it was not effectively executed. Therefore, the questions of the respective rights of

Pacific and surety as to the bonds were actually severed at date of trial, however, the District Court apparently proceeded as on summary judgment and concluded that as a matter of law and irrespective of the proof of the execution of the purported surety bond by Pacific, that the Bank was entitled to priority as to the bonds. Therefore, as between Bank and surety, the issues cannot now be resolved adversely to the Bank until a later fact determination is made as to whether or not the surety bond and the subordination contained in it was executed by Pacific. The Court can, however, as did the District Court, hold as a matter of law, and irrespective of the subordination agreement contained in the bond, that the Bank is entitled to priority. Therefore, this cross-appellee will proceed on that basis as regards

the cross-appeal of Pacific.

Turning then to the cross-appeals of Pacific and Martin, we find that every contention raised by cross-appellants Pacific and Martin has been previously raised and decided in cases involving the relative rights of sureties and assignees in cases construing improvement district contracts, warrants, assessments and bonds, which are nearly identical to those involved in the present case and arising under Improvement District Statutes, also nearly identical. These issues have been uniformly and completely answered in favor of the cross-appellee Bank, as the assignee.

The Arizona Improvement District Statutes under which the Wilmot Improvement District Contract was let, and the warrant, assessments, and bonds in question issued, so far as pertinent, are

Arizona Revised Statutes, Section 9-671 through 9-695, inclusive, which statutes were adopted from the statutes of the State of California in force at the time of adoption, 1912. (Historical note, Secs. 9-671 through 9-695, inclusive, Arizona Revised Statutes of 1956, and, in particular, the more pertinent portions thereof, A.R.S. 9-683, 9-684, 9-686 and 9-687.)

The specific questions raised on this appeal, that is, the relative rights and priorities of an assignee of the proceeds of an improvement district contract who has served notice of said assignment upon the public body, and the rights of the surety who has been compelled to pay labor and material claims has never been passed upon by the Supreme Court of the State of Arizona. Therefore, we must look to the

decisions of the highest Court of the state from which we adopted the statutes, which decisions will "be most persuasive" - if not conclusive. City of Tucson v. Superior Court of Pima County, 406 P.2d 227, 2 Ariz. App. 25; Peterson v. Flood, 326 P.2d 845, 84 Ariz. 256, In Re Lynch's Estate, 377 P.2d 199, 92 Ariz. 354.

Looking then to the cases of the State of California, from which, as above noted, we adopted the statutes in question, we find that the questions raised by the cross-appellants Martin and Pacific on their cross-appeals have been repeatedly raised and have been repeatedly stricken down in favor of the assignee Bank. Adamson v. Paonessa, 179 P. 880; Los Angeles Rock & Gravel Co. v. Coast Construction Co., et al and American Surety Co. of New York v.

Empire Securities Co., et al, 197 P. 941; McMorrey v. Superior Court, 201 P. 797; U. S. Fidelity and Guaranty Co. v. City of Los Angeles, 203 P. 151

In the Paonessa case, Paonessa contracted with the City of Colten, California, and gave a surety bond on which National Surety was the surety, all pursuant to the California Improvement District Statutes of 1911 which, as above noted, were adopted by the State of Arizona as Arizona Revised Statutes, Sec. 9-671 through 695, inclusive. Paonessa subsequently assigned the contract proceeds to one Lloyd, who served notice of the assignment upon the City of Colten. Thereafter, Paonessa completed the work but left unpaid material and labor claims which were paid by National Surety. When Lloyd, as assignee of Paonessa, and the surety company

both demanded the improvement district bonds issued by the City of Colten, the surety and assignee were interpleaded by the City. The assignee, of course, claimed under his collateral assignment and the surety by equitable subrogation. The Court held that laborers and materialmen had no "claims against the work" nor any rights in the contract proceeds (Bonds) but that their sole recourse was against the surety bond given by the contractor. Therefore, the laborers and materialmen having no claims against the bonds to which the surety could become subrogated, as between the surety, the laborers and materialmen and the assignee, the assignee takes priority. The Court specifically distinguished the case upon which cross-appellants Pacific and Martin rely. Prairie State National Bank v. U.S., 164 U.S. 227,

noting that in the Prairie State National Bank case and the others following that line of reasoning, the facts, although basically the same as in the Paonessa case (and the instant case) were critically different, in that, in those cases a fund was reserved for the benefit of laborers and materialmen creating a fund against which laborers and materialmen might have a claim and to whose rights the surety might be subrogated. However, under the California Statutes, and also under the Arizona Statutes, there is no such fund against which the laborers and materialmen have a right, they solely having a claim against the surety bond and, therefore, there is no claim against the contract proceeds to which the surety can become subrogated. Therefore, the assignee must prevail over the surety.

The cases of Los Angeles Rock & Gravel Co. v. Coast Construction Co. and American Surety Co. of New York v. Empire Securities Co., 197 P. 941, two consolidated cases, follow the Adamson v. Paonessa case very closely. Again the same claims as in the instant case were raised by the surety as against the assignee of the proceeds of a public works contract. The cases again held that the laborers' and materialmen's rights were solely against the surety bond and that they had no claim against the work or against the proceeds of the contract and thereby also striking down the surety's claim to subrogation or exoneration. The surety in these cases contended, as do cross-appellants herein, that because the contract contained a clause which provided that the contractor was to turn over the work free and clear

of all claims of laborers and materialmen, upon the contractor failing to pay all material and labor claims, the assignee had no right to the contract proceeds, as they were not due, and therefore the laborers, materialmen and the surety could reach the funds. The Court stated that it would not consider the question of the validity of the clause, which was inserted in the contract without statutory authority, and they held that:

> "...the clause in question merely expresses the general legal duty on the part of the contractor to pay all materialmen and laborers. It imposes no additional burden on the contractor but simply reduces to writing the nature of the legal duty in regard to such matters assumed by the contractor and which would exist whether in writing or not."

There is, likewise, no statutory authority in Arizona for the contract provision in question and to the contrary it

is to be noted that the Arizona Statutes, adopted, as noted, from the California Statutes, and in particular, A.R.S. 9-680 (e) provides:

> "Upon completion of the work, the contractor shall be entitled to the issuance and delivery of the assessments as provided in this article."

thereby giving the contractor, as in the Los Angeles Rock & Gravel Co. v. Coast Construction Company case (supra), an absolute right to the issuance and delivery of the warrant and assessment upon completion of the work. Again, there is no fund reserved for the protection of laborers and materialmen to whose rights the surety might become subrogated.

In any event, the question of whether laborers and materialmen could have a "claim" or "demand" against the work, has been answered in the negative

by the Supreme Court of the State of Arizona. Webb v. Crane, 52 Ariz. 299, 80 P.2d 698 laid the question to rest when it held that laborers and materialmen have no lien rights (the only claim or demand they could have) on any public building and, therefore, neither could any such claim (lien) exist against a public improvement, street or any other public property.

The third pertinent case, United States Fidelity & Guaranty Co. v. The City of Los Angeles (supra) involves an uncannily identical fact situation to the instant case and was one in which the surety company raised identical claims to those raised by Pacific and Martin here. These contentions were all stricken down and the assignee (here, the Bank) was given priority to the proceeds of the construction contract, the

warrant, the assessment and the bonds.

The Court again stated:

> "There is no provision which gives any such claimant (materialmen and laborers) any right or lien, equitable or otherwise upon money or bonds coming to the contractor."
>
> And,
>
> "Where the contractor has assigned before the surety sues to require the application of the debt the surety cannot succeed as against the assignee."

The Court, in that case pointed out that the statutes in question even contemplated that the warrant and assessment would be assigned. So do the Arizona Revised Statutes, as Sec. 9-686 provides that the warrant signed by the Superintendent of Streets and countersigned by the Mayor, shall state as follows:

> "...do authorize and empower (name of contractor) his agents or <u>assigns</u> to demand and receive the several assessments upon the assessment hereto attached and this shall be his warrant for the same." (emphasis supplied)

The foregoing cases firmly establish, that under the fact situation in the instant case, the rights of the assignee are superior to those of laborers, materialmen or sureties to the contract proceeds.

The foregoing should be sufficient to dispose of the contentions of Martin and Pacific. However, there is a further reason why cross-appellants' arguments are not valid. The argument that the contract required the work to be delivered free and discharge of claims for laborers and materialmen is not only invalid because the work <u>was</u> delivered free of such claims as above noted, but for the further reason that assuming, arguendo, there was any such claim, the contract in question was between Construction and City and it is without question that City could waive that

contract provision as against Construction or Martin. 44 Am.Jur., Public Works, Sec. 59, et seq, notes that, in the absence of any controlling legislative provisions, where the retention by public authorities of monies due to contractor until laborers and materialmen of the contractor have been paid is a matter of contract between the contractor and the public body (as it was here), it is clear that the public authorities may waive the provision and pay the contractor without requiring proof that he paid his laborers and materialmen, and without incurring any liability to them. In this case, if there was any such right, it is clear that it was waived, for the warrant and assessment was delivered to the contractor, Construction, or its assignees. (Stipulation, page 5) Further, the

bonds were executed and issued (Stipulation, page 7) and deposited in the registry of the Court. Obviously then, the City, if it had any right to retain the warrant, assessment or bonds, had waived such right, and by such waiver does not incur any liability to Pacific or Martin. In fact, the City has expressly done so in its answer to the complaint and cross-claims herein and in its answering brief on Trustee's appeal, as it has taken the position of a mere stakeholder, claiming no interest itself in the bonds in question or any right to retain them.

Further and conclusively, Martin and Pacific are precluded by statute from now claiming that the Wilmot Improvement District Contract was not fully completed according to its terms, or to claim that the City had a right

to retain the bonds.

A.R.S. Secs. 9-686 (h) and 9-687 (a) provide that the warrant and assessment shall be recorded in the office of the Superintendent and that after they are recorded they shall be delivered to the contractor as was done in the instant case (Stipulation, page 5). Thereupon, pursuant to A.R.S. Sec. 9-687 (e), the governing body holds a hearing to pass upon the assessment and proceedings. At which time, pursuant to A.R.S. Sec. 9-687 (f):

> "The owners, contractors and all other persons directly interested in the work or in the assessments, who have any objection to the legality of the assessment or to any of the previous proceedings connected therewith, or <u>who claim that the work has not been performed according to the contract</u> may, prior to the time fixed for hearing, file a written notice briefly specifying the grounds of their objection." (emphasis supplied)

A.R.S., 9-687 (f) further provides that:

> "The decision of the governing body shall be final and conclusive upon all persons entitled to object as to all irregularities, errors, informalities, and irregularities which the governing party might have remedied or voided at any time during the progress of the proceedings."

Nowhere does it appear that Pacific or Martin objected and by Resolution No. 5664, December 16, 1963 (Joint Exhibit No. 23), the City of Tucson approved the assessment and previous proceedings for the Wilmot Improvement District Contract (Stipulation, page 7), thereby forever precluding any claim by Pacific or Martin that the work was not completed according to the contract.

In a brief closing comment on the cases cited by the cross-appellants in support of their position, it is again

important to note that in each such case there was a specific percentage of the contract retained as a fund for the protection of laborers and materialmen, to which the surety can become subrogated. Where there is no such retained fund or if there be some retainage, but there be excess funds above such percentage retention, the assignee of the contractor is entitled to priority thereto over the claims of the laborers, materialmen or the surety as to the contract proceeds or the excess funds over the amounts so specifically retained. Hall & Olsway v. Aetna Casualty & Surety Co., 296 P. 162. Further each of the three cases relied on by cross-appellants were U. S. Government Contracts, each retaining a percentage fund for the protection of laborers and materialmen. In fact, in one case

(Henningsen v. United States Fidelity & Guaranty Co., 208 U.S. 404) the assignee's assignment was apparently void under the federal code and the court was merely dealing with bare equities, not with a legal, written, accepted assignment. Also, the Hochevar v. Maryland Co., CA 6, 114 F.2d 948 case relied on by cross-appellants, not only had a specific 15% retention fund, but the contractor was required to consent in writing and in advance to the application of the fund to the claims of laborers and materialmen. The case did not hold that the surety had a right to the retainage, but merely that under the consent to apply the funds it had a right to such application.

One further consideration of cross-appellant Pacific's position is in order. In each of said cross-appellant's cases,

the surety had paid the claims of laborers or materialmen or completed the work, thereby giving rise to whatever rights it might have while in this case there is no evidence of any payment by surety to anyone and in fact, Pacific was disputing Martin's claim to recover.

In any event, as above noted, the truly controlling factor is that under the pertinent statues and the Improvement District Contract, Martin has no claim or right to the bonds and there was no fund reserved for the protection of the laborers and materialmen to which the surety could become subrogated, therefore, the principles set forth in cross-appellant's cases are simply not applicable to the instant fact situation, and the cases above cited by Bank herein must be followed.

CONCLUSION

Arizona adopted the Improvement District Statutes under which the instant case arose from California and the California cases have very clearly and repeatedly refuted and stricken down every contention raised by cross-appellants Pacific and Martin in the instant case and have upheld the rights of the assignee (in this case, Bank) as against them. Also, the cross-appellants are precluded by statute from now raising any claims that the contract was not completed according to its terms. Therefore, it is clear that, as between cross-appellee Bank, as the assignee of Construction whose assignment was duly served upon the City and accepted, and Pacific and Martin as surety and materialmen respectively, the Bank's claim is prior to that of

Pacific or Martin, as their claim must rest solely upon the equitable assignment which was executed, served and accepted subsequent to the assignment of the Bank. Therefore, the judgment of the District Court that the Bank has, to the extent of its unpaid note, a prior right in the improvement district bonds to that of Pacific and Martin, must be affirmed.

Respectfully submitted,

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No. 20390

In the

United States Court of Appeals

for the Ninth Circuit

A. BATES BUTLER, as Trustee of CONSTRUCTION MATERIALS CO.,
Appellant,

vs.

CITY OF TUCSON, et al.,
Appellees.

MARTIN CONSTRUCTION CO. and PACIFIC NATIONAL INSURANCE CO.,
Appellants,

vs.

BANK OF TUCSON, et al.,
Appellees.

On Appeal from the United States District Court
for the District of Arizona

Answering Brief of Appellees Pacific National Insurance Company and Martin Construction Company

Opening Brief on Cross-Appeal

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No. 20390

In the

United States Court of Appeals

for the Ninth Circuit

A. Bates Butler, as Trustee of
Construction Materials Co.,
Appellant,

vs.

City of Tucson, et al.,
Appellees.

On Appeal from the United States District Court
for the District of Arizona

Answering Brief of Appellees Pacific National Insurance Company and Martin Construction Company

---

PREFATORY NOTE

Throughout this brief and the following brief on cross-appeal, appellant A. Bates Butler, trustee in bankruptcy of Construction Materials Co., bankrupt, is referred to as "Trustee;" Construction Materials Company as "Construction;" City of Tucson as "City;" The Bank of Tucson as "Bank;" Martin Construction Company as "Martin," and Pacific National Insurance Company as "Pacific."

Most of the ultimate facts in the trial court were undis-

puted, and were made part of the record by a written Stipulation of Facts filed December 7, 1964, which stipulation is listed as document No. 28 in the Clerk's Certificate to Record on Appeal. This document is cited hereinafter as "Stipulation."

JURISDICTIONAL STATEMENT

Trustee invoked the jurisdiction of the United States District Court for the District of Arizona under the provisions of Title 11 USC Chapter 7, Section 110 and amendments thereto, Section 70 of the Bankruptcy Act (Count III, Complaint). Jurisdiction of this court on appeal is asserted under Title 11 USC Chapter 4, Section 47.

STATEMENT OF THE CASE

Trustee under Counts I and II of his Complaint sought to set aside transfers by City to Bank under two improvement district contracts, and by Count III to obtain possession of certain improvement district bonds to be issued by City under one of said contracts. Count I dealt with the El Campo Estates Improvement District Contract (Joint Exhibit 1) and Counts II and III with the Wilmot Improvement District Contract (Joint Exhibit 18). Trustee in his Opening Brief abandoned his appeal as to Counts I and II of the Complaint, thereby limiting his appeal to his claim to the improvement district bonds under the Wilmot contract. Trustee's statement of the facts of the case, however, is directed in part to the El Campo district contract and an assignment of proceeds thereunder, which are no longer germane to this appeal. It becomes necessary, therefore, to supplement Trustee's statement with certain facts pertinent to the Wilmot Improvement District Contract.

On or about March 26, 1963, Construction and City entered into the Wilmot Improvement District Contract; on the same date, Pacific as surety executed a labor and material bond and performance bond which were incorporated in said contract. By letter agreement (Joint Exhibit 32) dated May 8, 1963, Martin agreed to furnish all materials, labor and equipment necessary to complete certain portions of the said contract, and Construction agreed to assign approximately $68,754.42 of the bonds on the project to Martin. It was stipulated at trial by all parties except Trustee, who disavowed any interest in Martin's claim, that Richard L. Martin, president of Martin, would testify that Martin performed the work under Joint Exhibit 32 and remained unpaid (Transcript of Proceedings, pp. 111-112).

Martin's claim upon the City for bonds to be issued in connection with the contract in the sum of $68,754.42 (Joint Exhibit 21) was acknowledged by memorandum (Joint Exhibit 22) circulated on or about September 6, 1963, by the director of finances and administration of City (Stipulation).

Bonds in the total sum of $57,383.64 were duly issued by City and on November 20, 1964 delivered to the Clerk of the United States District Court (Stipulation).

The trial court concluded that Martin had an equitable lien against the said bonds, subject and inferior to the right of Bank under an assignment by Construction on or about April 2, 1963, but superior to Trustee's claim. (The respective rights of Martin and Bank are the subject of the Opening Brief on Cross-Appeal, *infra*.)

ARGUMENT

Construction's agreement in writing on May 8, 1963, to assign to Martin certain improvement district bonds cre-

ated an equitable lien upon said bonds which was perfected no later than September 6, 1963, when City received notice of the claim.

While a mere agreement to assign a debt or chose in action at some future time will not operate as an assignment thereof so as to vest any present interest in the assignee, in equity under certain circumstances an agreement to assign or an agreement to pay a debt out of a certain fund may operate as a valid assignment; 6 CJS 1092, Assignments Section 43.

An equitable assignment is such an assignment as gives the assignee a title which, although not cognizable at law, equity will recognize and protect. It is in the nature of a declaration of trust, and is based on principles of natural justice and essential fairness, without regard to form; 6 CJS 1045, Assignments Section 1(b).

An assignment which a court of equity will recognize and which a court of law will not constitutes an equitable assignment, it being implied from the circumstances and because of the equities involved, and recognized solely because the assignee is a purchaser for value. No particular form is necessary to constitute an equitable assignment, and any words or transactions which show an intention on the one side to assign and an intention on the other to receive, if there is a valuable consideration, will operate as an effective equitable assignment; 6 CJS 1101, Assignments Section 58, *et sequitur.*

Where the transaction is evidenced by a written agreement, it depends on the intention of the parties as manifested in the writing construed in the light of such extrinsic circumstances as, under the general rules of law, are admissible in aid of the interpretation of written instruments. *Ibid,* page 1102.

To work an equitable assignment there must also be an actual or constructive appropriation of the subject matter. *Ibid,* page 1102.

The test is whether the debtor, here the City, would be justified in paying the debt to the person claiming to be the assignee. *Ibid,* page 1107, n. 53.

The foregoing rules are enunciated in Arizona case law, including those cases cited in Trustee's opening brief. The language from *Stephen v. Patterson* (1920), 21 Ariz. 308, 311, 188 Pac. 131, 132, quoted on page 5 of Trustee's brief, seems applicable to the present case. On the other hand, the quotation from *Moeur v. Farm Builders Corp.* (1929), 35 Ariz. 130, 138, 274 Pac. 1043, 1045, appearing on the same page, is inappropriate to the present case. The statement in the *Moeur* case that a promise to pay out of a particular fund does not give to the promisee an equitable assignment or lien upon such fund, or the property from which the fund is obtained, has no application where "Contruction Materials Company agreed to assign approximately $68,754.42 of the bonds on this project to the Martin Construction Company" (Joint Exhibit 32). Where there is a promise to pay a portion of a fund (rather than to pay out of a fund), or to assign property to be obtained by the promisor (rather than to pay out of the proceeds of such property), a lien arises under the familiar rule of equity that a contract to convey a specific object even before it is acquired will make the contractor a trustee as soon as he gets title to the thing. See the opinion of Mr. Justice Holmes in *Barnes v. Alexander*, 232 U.S. 117, 58 L.ed. 530, 34 S.Ct. 276, affirming *Barnes v. Shattuck*, 13 Ariz. 338, 114 Pac. 952, in which the promise of one attorney to pay another attorney one-third of a fee to be received by the former was held to create a lien on such fee in

favor of the latter. In *Barnes v. Shattuck* (1911), 13 Ariz. 338, 343, 114 Pac. 952, 954, the Arizona Supreme Court stated:

> "To constitute an equitable assignment good as between the assignor and assignee, it is not essential that the debt should have been earned or the fund be *in esse* at the time of the assignment, or that notice be given the present or future holder of the fund. The intent of the parties to create the lien being apparent, it is sufficient that there be a reasonable expectancy that the debt will be fully earned and the fund come into existence."

Likewise, in *Allen v. Hamman Lumber Co.* (1934), 44 Ariz. 145, 148, 34 P.2d 397, 399, the Arizona court said:

> "* * * The general rule of law is that the true test of an equitable assignment is whether the debtor would be justified in paying the debt to the person claiming to be the assignee, and that an assignment may be by parol or in writing, or partly in writing and partly oral. Any language, however informal, which shows an intention of an owner of a chose in action to transfer it so that it will be the property of the transferee will amount to an equitable assignment if sustained by a sufficient consideration. In 5 C.J. 927, it is said: 'An order drawn on a debtor, payable out of a debt or fund in or coming into his hands, will operate as an assignment of either the whole or part of such debt or fund, depending on whether the order is for the whole or for a part thereof, if the order is accepted by the drawee * * *.'"

Under the rule of the *Allen* case, the true test of an equitable assignment is whether the debtor would be justified in paying the debt to the person claiming to be the assignee. Certainly under the terms of the letter agreement of May 8, 1963 (Joint Exhibit 32), and the undisputed testimony that

Martin performed under the letter agreement and remained unpaid, City would have been justified in delivering the improvement district bonds to Martin, rather than Construction.

The trial court in enforcing the agreement by Construction in Joint Exhibit 32 to assign the improvement district bonds, and concluding that a lien was created thereby, applied the fundamental rule that equity treats as done that which should have been done. *Phoenix Title and Trust Co. v. Alamos Land and Irrigation Co.* (1922), 24 Ariz. 499, 211 Pac. 570. The conclusion that Martin's rights to the bond are superior to those of the Trustee must be affirmed.

Respectfully submitted,

CHANDLER, TULLAR, UDALL & RICHMOND
By JAMES L. RICHMOND
Attorneys for Appellees
Pacific National Insurance
Company and Martin
Construction Company

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES L. RICHMOND

No. 20390

In the

United States Court of Appeals

For the Ninth Circuit

MARTIN CONSTRUCTION CO. and
PACIFIC NATIONAL INSURANCE CO.,
Appellants,

vs.

BANK OF TUCSON, et al.,
Appellees.

On Appeal from the United States District Court
for the District of Arizona

Opening Brief on Cross-Appeal

The Prefatory Note, Jurisdictional Statement, and Statement of the Case in the Answering Brief of Appellees Pacific National Insurance Company and Martin Construction Company, *supra*, are adopted herein by this reference.

SPECIFICATION OF ERROR

The District Court erred in its conclusion that Martin's rights to the improvement district bonds were inferior to those of Bank as Construction's assignee, because Construction, never having paid Martin's claim for labor and materials, never perfected its right to receive the bonds, and because an unpaid subcontractor, like Martin, or a surety required by the terms of its obligation to pay such unpaid subcontractor, like Pacific, has a right to the extent of the

claim of the unpaid subcontractor in the undelivered contract proceeds superior to any right of the defaulting prime contractor or its assignee.

ARGUMENT

Martin, the unpaid subcontractor, and Pacific, surety on the labor and material bond, assert that their rights are coextensive on this cross-appeal, and superior to those of Bank. It is their position that Construction, never having paid Martin, breached its contract and never perfected its right to the improvement district bonds. Bank, as Construction's assignee, could acquire no greater rights than its assignor.

The Wilmot Improvement District Contract, at page 97 of Joint Exhibit 18, provides as follows:

> "The party of the first part (Construction Materials Co.) further agrees that it will do and perform said work . . . and that it will, within the time hereinafter fixed, turn the said work over to the said Superintendent of Streets, complete and ready for use *free and discharged of all claims and demands whatsoever, for or on account of any and all labor and materials used or furnished to be used in said improvements.*
>
> "And the said party of the second part (the Superintendent of Streets of the City of Tucson, as contracting agent for the improvement district) . . . promises and agrees that *upon the performance of the covenants aforesaid by the said party of the first part,* he will make and issue an assessment. . . ." etc. (Emphasis supplied).

It is evident from the foregoing that any right of the contractor to payment under the improvement district contract is on the express condition that it first perform its covenants, including its covenant that it will "turn the said

work over to the said Superintendent of Streets, complete and ready for use free and discharged of all claims and demands whatsoever, for or on account of any and all labor and materials used or furnished to be used in said improvements."

Furthermore, by the terms of the labor and material bond at page 99 of Joint Exhibit 18, Construction as principal binds itself, its heirs, successors and *assigns*, in the amount of $87,748.93 on the express condition that it "shall promptly make payment for all labor performed and services rendered and materials furnished in the prosecution of the work" provided for in the Wilmot contract.

City on September 6, 1963, received a letter written on behalf of Martin, reciting a claim of $68,754.42 for materials, labor and equipment furnished in connection with the Wilmot contract. Improvement district bonds in the sum of $57,383.64 were issued by City and delivered to the Clerk of the United States District Court subsequent to receipt of the letter by the City.

Under these facts Construction would only have become entitled to the improvement district bonds had it completed its job and paid its laborers and materialmen; City had a right to use the bonds to pay laborers and materialmen; Martin had a right to be paid out of the bonds, and surety upon payment of the laborers and materialmen would become entitled to the benefit of all these rights to the extent necessary to reimburse it. *Pearlman v. Reliance Ins. Co.*, 371 U.S. 132, 9 L ed 2d 190, 83 S.Ct. 232 (1962).

The *Pearlman* opinion under the Miller Act held that the government contractor, having failed to pay laborers and materialmen in accordance with the contract terms, never acquired any right under the contract to retained funds; therefore, no property interest therein vested in the con-

tractor's trustee in bankruptcy. The surety had paid the unpaid laborers and materialmen at the time of adjudication in bankruptcy. The majority opinion held that the surety was entitled to the retained funds, apparently through subrogation to the rights of the laborers and materialmen whom it paid. The opinion cites and reaffirms *Prairie State Nat. Bank v. United States,* 164 U.S. 227, 41 L ed 412, 17 S. Ct. 142 (1896), and *Henningsen v. United States Fidelity & G. Co.,* 208 U.S. 404, 52 L ed 547, 28 S.Ct. 389 (1908), in their holdings that a surety who completes a government contract, or who pays laborers' and materialmen's claims upon the prime contractor's default, stands in the shoes of the government as to the funds retained for completion of the contract, including payment of such claims. In both the *Prairie Bank* case and the *Henningsen* case, the rights of the surety were held superior to those of a bank which, like Bank in this case, had been assigned the retained contract proceeds as security for funds advanced to the contractor. The cases upheld an equitable right of the surety through subrogation to the rights which the United States might have asserted against the retainage, and held that such equity arose in favor of the surety on execution of the contract of suretyship and thus was prior in date and paramount to that arising in favor of the bank at the time of the subsequent assignment.

In addition, Pacific's right that City use the improvement district bonds in satisfaction of the labor and materials claims for which Pacific was surety is an independent right and thus not dependent upon subrogation. *Hochevar v. Maryland Casualty Co.* (CCA 6, 1940), 114 F2d 948, 951.

Under the rule of *Pearlman,* and the cases which it reaffirms, neither Construction nor Bank as its assignee could acquire any right to the improvement district bonds until

Martin's claim for labor and materials had been paid, and Pacific is entitled to have the bonds applied toward payment of the Martin claim. Thus, the trial court's conclusion of law that Martin's interest in the improvement district bonds is inferior to that of Bank was in error. The judgment of May 26, 1965, insofar as it provides for the delivery to Bank of improvement district bonds in the sum of $25,126.69, together with interest thereon at the rate of 6% per annum from December 12, 1963, until the date of judgment, should be reversed, and judgment entered in favor of Martin for the improvement district bonds in said amount.

Respectfully submitted,

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Attorneys for Cross-Appellants Martin Construction Company and Pacific National Insurance Company

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES L. RICHMOND

No. 20390

In the

United States Court of Appeals

for the Ninth Circuit

A. BATES BUTLER, as Trustee of CONSTRUCTION MATERIALS CO., *Appellant,*

vs.

CITY OF TUCSON, et al., *Appellees.*

MARTIN CONSTRUCTION CO. and PACIFIC NATIONAL INSURANCE CO., *Appellants,*

vs.

BANK OF TUCSON, et al., *Appellees.*

THE BANK OF TUCSON, *Appellant,*

vs.

PACIFIC NATIONAL INSURANCE COMPANY, et al., *Appellees.*

On Appeal from the United States District Court
for the District of Arizona

Answering Brief of Appellees Pacific National Insurance Company and Martin Construction Company on Cross-Appeal of The Bank of Tucson

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No. 20390

In the

United States Court of Appeals

for the Ninth Circuit

THE BANK OF TUCSON,

Appellant,

vs.

PACIFIC NATIONAL INSURANCE COMPANY, et al.,

Appellees.

On Appeal from the United States District Court
for the District of Arizona

Answering Brief of Appellees Pacific National Insurance Company and Martin Construction Company on Cross-Appeal of The Bank of Tucson

---

PREFATORY NOTE

The parties are referred to herein as follows: appellant The Bank of Tucson as "Bank;" A. Bates Butler, trustee in bankruptcy of Construction Materials Co., as "Trustee;" Construction Materials Company as "Construction;" City of Tucson as "City;" Martin Construction Company as "Martin," and Pacific National Insurance Company as "Pacific."

The jurisdictional statement in the Answering Brief of appellees Pacific and Martin on the primary appeal is adopted herein by this reference.

STATEMENT OF THE CASE

Appellees Pacific and Martin controvert Bank's recited Facts of the Case insofar as Bank assumes on page 6 of its Opening Brief on Cross-Appeal that the promissory note, Joint Exhibit 19, "was placed in the hands of the Bank's attorneys for collection." To the contrary, the record reveals that Bank had received the sum of $160,932.33 in payment on said note prior to commencement of this action by Trustee and pursuant to assignment was to receive municipal bonds in an amount sufficient to satisfy the balance due upon issuance of said bonds by City. The action below was not one instituted by Bank for collection, but instead one brought by Trustee to avoid the assignment under which Bank already had received $160,932.33 (Complaint, Count II) and was about to receive an additional sum in municipal bonds (Complaint, Count III).

ARGUMENT

It is the position of appellees Pacific and Martin that the District Court's Finding of Fact No. 25 that ten (10%) per cent of the amount found due from Construction to Bank would be an unreasonable attorney's fee was not "induced by an erroneous view of the law," as contended by Bank on page 15 of its Opening Brief on Cross-Appeal. It is the further contention of these appellees that the note was not "placed in the hands of an attorney for collection" within the meaning of the provision therein for attorney's fees.

Bank in urging that it was denied attorney's fees under an erroneous view of the law cites two Arizona cases as

adopting "by necessary implication" the rule "that where a stipulated per cent of a note is provided as attorneys' fees, such amount will be awarded in the absence of an issue as to and a showing of the unreasonableness thereof." Bank overlooks the most recent pronouncement of the Supreme Court of Arizona on the subject in *Elson Development Co. v. Arizona Savings and Loan Association*, 99 Ariz. 217, 407 P.2d 930, 934 (1965), as follows:

> "We hold that, in the instant case as to the three per cent stipulated in the agreement, it is not absolutely binding on the parties, or on the court, and the stipulation of three to four per cent as reasonable attorney's fees is binding only in the amount that the court finds to be reasonable from evidence."

From the foregoing, it is clear that the rule in Arizona is that stipulated attorney's fees are binding only in such amount as the court finds to be reasonable from evidence, thus affording a clear and correct legal basis for the District Court's finding herein that ten (10%) per cent of the amount due from Construction to Bank would be an unreasonable sum and its failure, in the absence of evidence as to what would be a reasonable attorney's fee, to award any amount for such fee.

Moreover, not every action affording recovery on a promissory note is one for collection within the provisions for attorney's fees. *Strickland v. Williams*, 215 Ga. 175, 109 S.E.2d 761, 763 (1959). Trustee by his Complaint attacked the assignment by Construction to Bank of the Wilmot Improvement Contract proceeds, seeking to set aside the transfer of $160,932.33 already received by Bank and to prevent the impending delivery of municipal bonds yet to be issued. Bank thus was called upon to defend the validity of the assignment under Count II of Trustee's Complaint as

to the funds previously received and under Count III as to the bonds yet to be issued and delivered. It would be ridiculous to suggest that the promissory note was "placed in the hands of an attorney for collection" of the $160,932.33 which Bank already had received, yet Bank's role in defense of its rights was identical as to both the funds previously received and the bonds subsequently issued and ultimately delivered pursuant to the assignment.

Finding of Fact No. 25 that ten (10%) per cent of the amount due from Construction to Bank would be an unreasonable attorney's fee is not clearly erroneous, and the provision in the promissory note for attorney's fees has no application to this case. For either reason, the failure of the District Court to award any amount as attorney's fees to Bank should be upheld.

Respectfully submitted

CHANDLER, TULLAR, UDALL
& RICHMOND

By JAMES L. RICHMOND

Attorneys for Appellees
Pacific National
Insurance Company and
Martin Construction
Company

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES L. RICHMOND

No. 20390

In the

United States Court of Appeals

For the Ninth Circuit

A. BATES BUTLER, AS TRUSTEE of Construction Materials Co.,
Appellant,

vs.

CITY OF TUCSON, et al.,
Appellees.

THE BANK OF TUCSON,
Appellant,

vs.

PACIFIC NATIONAL INSURANCE COMPANY, CITY OF TUCSON, MARTIN CONSTRUCTION COMPANY and A. BATES BUTLER,
Appellees.

MARTIN CONSTRUCTION CO., and PACIFIC NATIONAL INSURANCE CO.,
Appellants,

vs.

BANK OF TUCSON, et al.,
Appellees.

FEB 10 1967

On Appeal from the United States District Court for the District of Arizona

Reply Brief of Appellant A. Bates Butler, as Trustee of Construction Materials Co.

Answer to Cross Appeal of Appellees, Pacific National Insurance Company and Martin Construction Company

Answer to Cross Appeal of Appellee, Bank of Tucson

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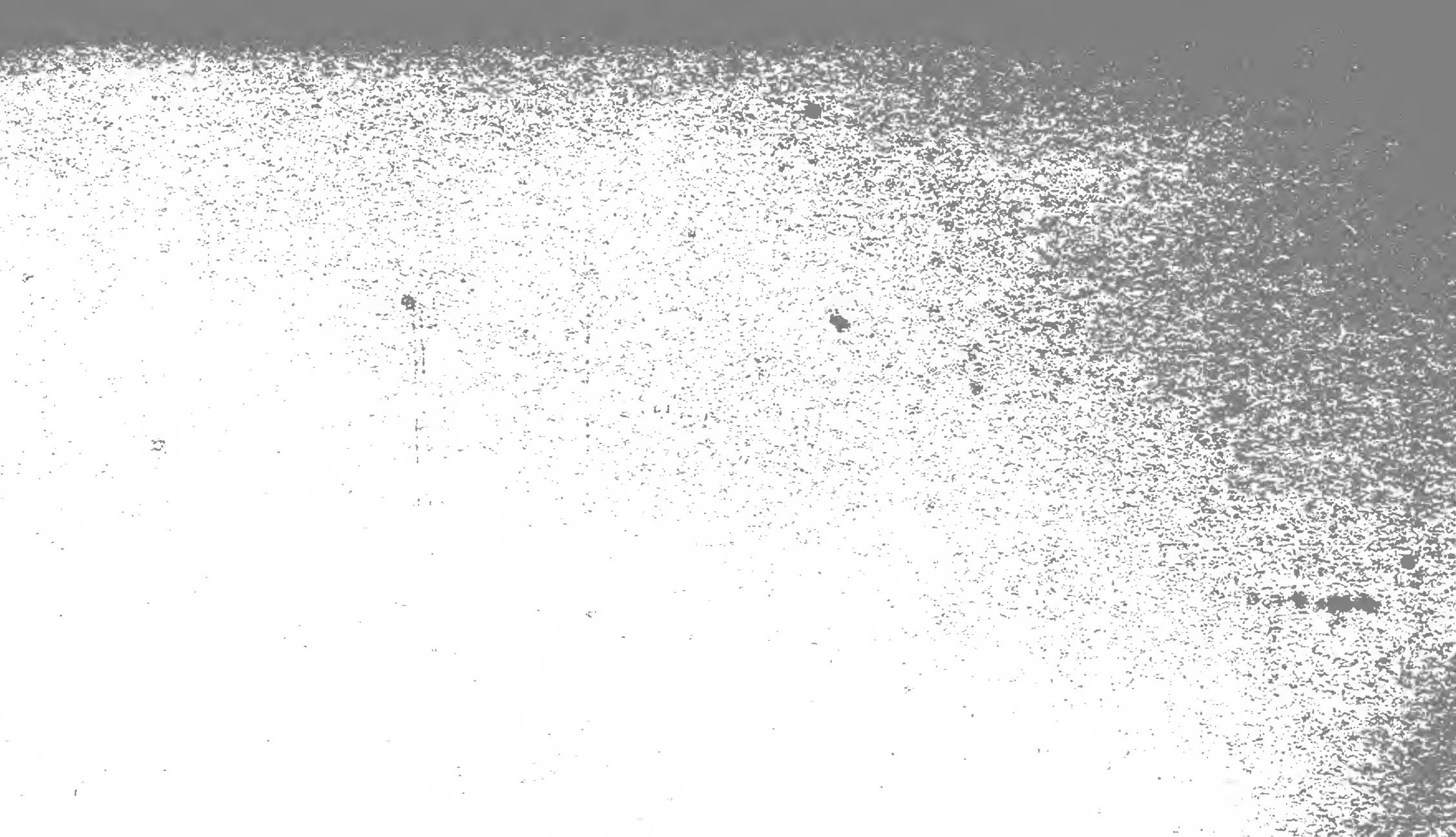

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INTRODUCTION

For the sake of clarity, A. Bates Butler, Trustee in Bankruptcy of Construction Materials Company, Bankrupt, Appellant, shall hereinafter be referred to as "Trustee." Construction Materials Company, bankrupt, will hereinafter be referred to as "Bankrupt." The City of Tucson, Appellee, will hereinafter be referred to as "City." The Bank of Tucson, Appellee, shall hereinafter be referred to as "Bank," Martin Construction Company, Appellee, shall hereinafter be referred to as "Martin," and Pacific National Insurance Company, Appellee, shall hereinafter be referred to as "Pacific."

In the

United States Court of Appeals

For the Ninth Circuit

A. Bates Butler, as Trustee of Construction Materials Co.,

Appellant,

vs.

City of Tucson, et al.,

Appellees.

On Appeal from the United States District Court for the District of Arizona

Reply to Answering Brief of Appellees Pacific National Insurance Company and Martin Insurance Company

---

ARGUMENT

A case directly on point and construing a situation almost identical to the present case at Bar is the case of *Adamson v. Paonessa* (1919) 180 Cal. 157, 179 P. 880 with a Company known as National Surety Company taking the identical position of Pacific in this case.

Adamson v. Paonessa deals with the problem of an assertion of an equitable lien arising out of Bonds pursuant to the California Improvement Act of 1911.

The present Arizona Code ARS 1956 indicates that this the California Improvement Act was the source of Arizona's

present day act that gave rise to the controversy concerning the Municipal Bonds in question.

Thus the case of *Adamson v. Paonessa* takes on added weight concerning the question of an equitable assignment.

The *Adamson v. Paonessa* case is so similar to the present fact situation that in discussing the case Appellant will not even paraphrase but will quote verbatim:

> The first ground advanced is that, by virtue of its payments as surety for Paonessa of the claims against him for materials and labor furnished, it acquired by subrogation an equitable lien upon any moneys or bonds due under the contract in payment for the work superior to any assignment or other disposition which Paonessa might have made. There is no doubt but that the payment by the surety company pursuant to its obligations as surety would work a subrogation in its favor of any rights which the claimants had whose claims were paid. It is equally clear that the subrogation would give no further rights than this. What rights, therefore, had these materialmen and laborers against the moneys or bonds that were due under the contract on the completion of the work? If they had none, and if their rights were limited to a personal recovery against Paonessa and to a recovery upon the bond given by the surety company, it is clear that there was nothing upon which the subrogation could work. Such we believe to be the case under the Improvement Act of 1911, under which the work was done.
>
> The only provision in the act of 1911 providing security to materialmen and laborers for the payment of their claims is section 19. This section requires that every contractor to whom a contract is awarded under the act must file with the superintendent of streets a good and sufficient bond inuring to the benefit of any and all persons performing labor on or furnishing materials used in the work or improvement. There is no provision which gives such claimants any right or

lien, equitable or otherwise upon money or bonds coming to the contractor. In particular, there is no provision in the act authorizing or permitting the retention by the municipality, or by the owners whose lands are assessed, of anything which may be due the contractor in order to pay the claims of materialmen or laborers, or permitting the deduction of the amount of such claims from anything that may be due the contractor. We are constrained to believe that it was the intention of the statute that parties furnishing materials or labor to a contractor doing work under a contract let in accordance with this act must look solely to the contractor's personal responsibility and to the bond which the statute requires him to furnish.

This construction of the statute is strengthened by a consideration of the method of payment contemplated by it. It contemplates that the contractor be paid directly by the property owners whose property is assessed for that purpose, each paying for himself his own assessment, and this whether the payment be in money or in bonds. It is true that any property owner may discharge the assessment on his property by making payment to the city treasurer, but the act clearly contemplates that the city treasurer in such case is merely acting as a convenient means or conduit whereby the property owner may make payment to the contractor. Essentially the payment is one by each property owner directly to the contractor.

It is manifest that under such circumstances there is no single fund out of which the contractor is to be paid and it is likewise clear that, in view of the fact that payment may be made to the contractor without the interposition of the city treasurer or any other city official or common conduit of payment, any right to have moneys or bonds coming to a contractor retained in order to meet claims against the contractor would be quite impracticable. The act provides no machinery by which the amount to be retained from the payment

by the property owner can be ascertained or he be notified of the amount he is to retain.

The result so arrived at is not affected by the provisions of section 1184 of the Code of Civil Procedure. That section, as amended in 1911, provides for the giving of notice by any person who has performed labor or furnished materials under a contract, and then continues as follows:

"Upon such notice being given it shall be lawful for the owner to withhold, and in case of property which, for reasons of public policy or otherwise, is not subject to the liens in this chapter provided for, the owner or person who contracted with the contractor, shall withhold from his contractor sufficient money due or that may become due to such contractor to answer such claims and any lien that may be filed therefor including the reasonable cost of any litigation thereunder."

This provision is clearly applicable only to cases where the contractor is to be paid either by the owner of the property upon which the work is done, or by the person, public or private, by whom the contract was made. It cannot be applied where payment is not to be made in that manner, but is to be made by a number of different persons not parties to the contract, each of whom pays independently his separate share of the amount due.

Right here also lies the difference between the present case and the line of authorities cited by appellant's counsel, beginning with Prairie State Nat. Bank v. United States, 164 U.S. 227, 17 Sup. Ct. 142, 41 L. Ed. 412. In those decisions the facts are essentially the same as in this, with the exception that either by statute or by the contract itself a fund was in effect reserved for the benefit of materialmen and laborers whom the contractor might fail to pay. In other words, the materialmen and laborers had a right as against a certain fund in addition to any recovery against the contractor or his surety. Under such circumstances, if the surety

> paid their claims, he would be subrogated to their rights against such fund. Such, however, is not the case here, as there is no fund against which the materialmen and laborers have a right.

Thus it appears that we have here an identical fact situation construing the identical claim (equitable assignment) under the identical statute but in a different state though within this same circuit.

WHEREFORE it is respectfully requested that the judgment of the District Court be reversed and that title be held to have bested in the Trustee free and clear of any equitable lien of Martin or Pacific.

In the

United States Court of Appeals

For the Ninth Circuit

MARTIN CONSTRUCTION CO., and PACIFIC NATIONAL INSURANCE CO.,	*Appellants,*
vs.	
THE BANK OF TUCSON, et al.,	*Appellees.*

On Appeal from the United States District Court for the District of Arizona

Answer to Cross Appeal of Appellees, Pacific National Insurance Company and Martin Construction Company

---

STATEMENT OF THE CASE

In plain and simple terms what has happened is that a Surety Company has paid a subcontractor on a claim for labor and materials.

ARGUMENT

It is Trustee's position that payment by a surety to subcontractor for a claim filed by the subcontractor gives the surety just whatever rights the subcontractor had against the City (or to the retained funds) and no greater rights. This is the law and has been settled in the case of *Adamson v. Paonessa*, (1919) 180 Cal. 157, 179 Pac. 880. This case is

almost exactly similar to the case at hand. Paonessa had entered into a contract to do certain work for the City of Colton. He filed a surety bond (for the payment of claims for materials, labor, etc.) National Surety Company was the surety on the bond. Paonessa had made a written application for the bond (in the case at hand we have no such written application.) A portion of the application reads as follows:

> "All payments specified in the above-mentioned contract (i.e. the contract with the City of Colton for doing the work) to be withheld by the obligee until the completion of the work shall, as soon as the work is completed, be paid to the Company (the surety company) and this covenant shall operate as an assignment thereof, and the residue, if any, after reimbursing the company as aforesaid, be paid to the applicant after all liability of the Company has ceased to exist under said bond."

No notice of this assignment (if it was an assignment) was given to the City. (In our case no notice of the indemnity agreement was given to the City.) While the work was in progress another defendant, Lloyd, advanced funds to Paonessa and took a written assignment of all his rights under the contract and filed the assignment with the City Clerk. When the job was completed the City recognized the assignment to Lloyd. The Surety then demanded the money (warrants) on the ground that they held an assignment by virtue of the bond application and the fact that they were called upon to pay approximately $10,000.00 for material and labor furnished which Paonessa had not paid. Judgment was entered against the Surety Company which then appealed and advanced two grounds for the appeal. Both of the grounds advanced are the grounds that Pacific in this case suggests as the basis for its claim:

1. That by virtue of its payment as surety for Paonessa of claims against Paonessa for labor and material furnished, it acquired by subrogation an equitable lien upon any monies due under the contract superior to an assignment or other disposition that Paonessa might have made, and
2. That by virtue of the application for the bond, he, Paonessa, had assigned to the surety his right to the money (warrants) to become due him under the contract with the City and this assignment being prior in time to the assignment to Lloyd, is prior in right.

In answer to the first point the court acknowledged that the surety by virtue of paying the claim pursuant to its obligation as surety obtained a subrogation in its favor of any rights which the claimant had whose claims were paid. But it was also true that the subrogation would give no greater rights than this. The Court then attempted to establish what rights these claimants would have had and decided that the claimants would have had no rights to the funds (warrants). The court then differentiated between that case and the *Prairie State National Bank v. U.S.*, (1846) 164 U.S. 227; 41 L.ed. 412, 17 S. Ct. 142 (relied upon by Pacific in this case to substantiate its position). In explaining the difference the court said: "In those decisions (Prairie State National Bank and others) the facts are essentially the same as in this, with the exception that either by statute or by the contract itself a fund was in effect reserved for the benefit of materialmen and laborers whom the contractor might fail to pay." (In our case neither the contract nor any statute made such a provision). "In other words, the materialmen and laborers had a right as against a certain fund in addition to any recovery against the contractor or his surety. Under such circumstances, if

the surety paid their claims, he would be subrogated to their rights against such fund. Such, however, is not the case here, as there is no fund against which the materialmen and laborers have a right."

Thus we see no statute providing for payment, no contract containing such a payment provision, and no fund out of which to make such payment. The claimant is limited to his right against the surety on the bond and the surety is subrogated to no greater right than the claimant whom he had paid.

The second point on appeal pertained to the notice of assignment given by the surety on the City. They had not given the bond and the court held the City was not bound by it since they did have notice of the assignment to Lloyd. In our case there was no written application for the bond, no assignment to Pacific. Pacific is attempting to become a third party beneficiary of at most an equitable assignment.

The case of *Hochevar v. Maryland Casualty Co.,* (CCA 6, 1940) 114 F. 2d 948 is not in point and is not authority for holding in favor of the Defendant. In that case a contractor entered into a contract with Belmont County, State of Ohio to do construction work on a highway. He did not finish a 100′ strip of the highway which fact the County was aware of. Notwithstanding this knowledge the County paid all sums due to the contractor less a statutory withholding amount. The contract had expressly provided for the county not to make the payment until final completion. In differentiating this case from cases more similar to the one we are involved with, the court said:

> "The decision of the Ohio Court of Appeals in Village of Beachwood v. Ohio Casualty Insurance Company, 47 Ohio App. 212, 191 N.E. 797, is not applicable inasmuch as the Village was not obligated by the contract, as was the County here, to retain the percentages until materialmen and laborers were paid, and, because of the

> dissimilar facts involved, no importance should here be attached to statements therein that the rights of the surety can rise no higher than those of materialmen or laborers; nor could we extend the rule of that case to this without disregarding the implications of State v. Schlessinger, 114 Ohio St. 323, 151 N.E. 177, decided by the Supreme Court of Ohio, whose declarations alone are binding upon us in this case. . . . The Ohio cases refusing to impose quasi-contractural duties upon counties are not applicable, because the counties duty arises from express provisions in its contract."

The case of *Pearlman v. Reliance Bus Co.*, (1962) 371 U.S. 132, 9 L. ed. 2d 190, 83 S. Ct. 232, relied upon by Pacific as authority for its position is not applicable to the factual situation present here. The *Pearlman* case relied upon the case of *Prairie State National Bank v. United States*, (1896) 164 U.S. 227, 41 L. ed. 412, 17 S. Ct. 142, for authority in its holdings. The *Paonessa* case (supra) completely differentiated the *Prairie State* case fact situation from the factual situation present in our case and clearly established that neither it (the *Prairie* case) or the *Pearlman* case is of any significance in the case at hand. In both the *Prairie State* case and the *Pearlman* case there was an express contract provision between the subcontractor and the surety providing for an assignment of "any and all percentages of the contract price retained on account of said contract, and any and all sums that may be due under said contract at the time of such . . . forfeiture or breach, or that thereafter may become due. . . ." There is no such assignment present in the case at hand.

CONCLUSION

It is respectfully submitted that the judgment of the District Court be reversed and that title be held to have vested in the Trustee free and clear of any claim of Martin or Pacific.

In the

United States Court of Appeals

For the Ninth Circuit

THE BANK OF TUCSON,
Appellant,

vs.

PACIFIC NATIONAL INSURANCE COMPANY, CITY OF TUCSON, MARTIN CONSTRUCTION COMPANY and A. BATES BUTLER,
Appellees.

On Appeal from the United States District Court for the District of Arizona

Answer to Cross Appeal of Appellee, Bank of Tucson

This portion of the Brief will relate to answering the Cross Appeal of the Bank of Tucson relating to the question of whether or not they are entitled to attorneys' fees in the sum of 10%, an amount specified in a promissory note.

FACTS OF THE CASE

The record will reflect that the Court found that the sum of 10% of the amount due would be an unreasonable sum to be allowed The Bank of Tucson as attorneys' fees in this case (Finding #25).

The only evidence offered by The Bank of Tucson upon the question of attorneys' fees was the Note itself. It contained a provision

that in the event the note was placed in the hands of an attorney for collection, the maker shall, in addition to all other sums found due thereunder, pay as attorneys' fees a sum equal to 10% of the amount found to be due.

ARGUMENT ON THE QUESTION PRESENTED

The general rule is quite clear that a stipulation as to an allowance of attorneys' fees on a promissory note is valid. However, to entitle one to recover attorneys' fees in a litigated matter he must tender evidence upon two propositions. First, that the party has in truth and in fact agreed to pay his counsel a fixed or reasonable sum for his services and second, the reasonableness of the fee. *Porter v. Title Guaranty & Surety Co.* (1909) 170 Idaho 364, 106 P. 299; *Lee v. Howard Broadcasting Corp.* (1957) Tex. Civ. App. 305 S.W. 2d 629. To justify the Court, then, in allowing attorneys' fees upon the basis of a provision in a note, the party claiming the fees must also prove that he has agreed to pay his counsel a stipulated or a reasonable fee for his services, and the reasonableness of the fee agreed upon, or what is a reasonable fee in such a matter. Upon this evidence being submitted to the Court it is then able to find the amount to be allowed in such a proceeding, but without such evidence there is nothing upon which the Court could base a finding allowing such a fee. In the present case there being no evidence that the Bank of Tucson has agreed to pay its counsel a fixed or a reasonable fee in this matter and there being no evidence as to what would be a reasonable fee for services rendered in such action the Court could do nothing but deny attorneys' fees to anyone.

The present case is stronger than the general rule for the facts are quite clear that it was this Answering Appellant that had to sue to have a determination relating to whose funds these were. It wasn't the Bank of Tucson.

What the Bank of Tucson argues is that the Appellant is to proceed and prove that their fee is unreasonable when the Appellant doesn't even know the amount or for that matter whether this particular litigation is covered by a monthly or yearly retainer, that Appellant should put on expert testimony as to what the fee for this trial should be when there would be nothing available to the Appellant to propose the question as to time spent, the talent employed on the case, the amount of legal research conducted, the intricacies of the questions that came up during the preparation of the case and the amount of preparation actually accomplished. These are all matters peculiarly within the control of The Bank of Tucson and not this Answering Appellant.

Therefore the finding of the Court in relation to the question was proper.

LAWRENCE OLLASON

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

LAWRENCE OLLASON

No. 20390

In the

United States Court of Appeals

For the Ninth Circuit

A. BATES BUTLER, as Trustee of CONSTRUCTION MATERIALS CO.,

Appellant,

vs.

CITY OF TUCSON, et al.,

Appellees.

MARTIN CONSTRUCTION CO. and PACIFIC NATIONAL INSURANCE CO.,

Appellants,

vs.

BANK OF TUCSON, et al.,

Appellees.

On Appeal from the United States District Court
for the District of Arizona

Reply Brief on Cross-Appeal of Appellees Pacific National Insurance Company and Martin Construction Company

---

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No. 20390

In the

United States Court of Appeals

For the Ninth Circuit

MARTIN CONSTRUCTION CO. and PACIFIC NATIONAL INSURANCE CO.,

Appellants,

vs.

BANK OF TUCSON, et al.,

Appellees.

On Appeal from the United States District Court
for the District of Arizona

Reply Brief on Cross-Appeal of Appellees Pacific National Insurance Company and Martin Construction Company

---

ARGUMENT

While Bank has elected to open its argument in answering Martin and Pacific's opening brief on cross-appeal with a

discussion of issues which were not tried, and with a quotation from an exhibit which was marked for identification but never admitted in evidence, the issue on this cross-appeal ultimately resolves into whether the rule of *Adamson v. Paonessa,* 180 Cal. 157, 179 Pac. 880 (1919), is to prevail over the line of authorities beginning with *Prairie State Nat. Bank v. United States,* 164 U.S. 227, 41 L.ed. 412, 17 S. Ct. 142 (1896), as reaffirmed and extended in *Pearlman v. Reliance Ins. Co.,* 371 U.S. 132, 9 L.ed. 2d 190, 83 S.Ct. 232 (1962).

On the other hand, Bank suggests in its Supplemental Statement of Case that "issues as between Bank and Pacific were severed for later trial." As the record will reflect, Bank's cross-claim again Pacific was severed and reserved for separate trial in the event that Pacific or Martin were to succeed on their cross-appeal. Conflicting claims of Bank and Pacific to the improvement district bonds which were the subject of Count III of the Complaint, however, obviously were tried below and are the subject of this cross-appeal.

Adamson distinguished *Prairie State* because in the latter case there was a fund which was in effect reserved for the benefit of materialmen and laborers whom the contractor might fail to pay. The distinction seems artificial where, as here, the contract provides for *no* payment until the contractor has turned over the work, "complete and ready for use free and discharged of all claims and demands whatsoever, for or on account of any and all labor and materials used or furnished to be used" in the improvements, and the improvement district bonds had not been issued at the inception of the litigation. Bank as assignee of the contractor's rights had full notice of the limitations on those rights

expressed in the contract, and thus can stand in no better position than its assignor.

Bank also contends that Martin and Pacific are precluded from complaining that Martin's claim was not paid because they failed to file written objections under a statute (A.R.S. Sec. 9-687 F.) which by its terms is limited in effect to "errors, informalities and irregularities which the governing body might have remedied or avoided at any time during the progress of the proceedings." Construction's failure to pay Martin clearly was not such an error, informality or irregularity, and was subject to remedy or avoidance at any time up to and including the issuance of the improvement bonds and their delivery on November 20, 1964, to the Clerk of the District Court. It is stipulated that City received Martin's verified claim on January 3, 1964, and that the resolution providing for issuance of the improvement bonds was adopted subsequently on January 20, 1964.

It is axiomatic that a contract must be construed so as to give meaning to all the words and clauses used by the parties. *Doran v. Oasis Printing House*, 24 Ariz. 475, 211 Pac. 562 (1922). The court in construing a contract should give some effect to every part thereof, if possible. *Aldous v. Intermountain Bldg. and Loan Ass'n of Ariz.*, 36 Ariz. 225, 284 Pac. 353 (1930). To hold that Bank as assignee of Construction was entitled to payment of the as yet unissued and undelivered improvement district bonds prior to the discharge of Martin's claim for labor and materials is to render meaningless the clear and unequivocal language of the contract requiring Construction to turn over the work free and discharged of such claim prior to payment. The rule of *Pearlman v. Reliance Ins. Co., supra*, should be ap-

plied, and the judgment reversed insofar as it subjugates Martin's rights to those of Bank.

Respectfully submitted,

CHANDLER, TULLAR, UDALL & RICHMOND

By JAMES L. RICHMOND

Attorneys for Appellees
Pacific National Insurance Company
and Martin Construction Company

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JAMES L. RICHMOND

No. 20390

IN THE
UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

A. BATES BUTLER, as Trustee of CONSTRUCTION MATERIALS CO.,

Appellant,

vs.

CITY OF TUCSON, et al.,

Appellees.

MARTIN CONSTRUCTION CO. and PACIFIC NATIONAL INSURANCE CO.,

Appellants,

vs.

BANK OF TUCSON, et al.,

Appellees.

On Appeal from The United States District Court for the District of Arizona

REPLY TO ANSWERING BRIEF OF APPELLEES, PACIFIC NATIONAL INSURANCE COMPANY AND MARTIN CONSTRUCTION COMPANY AND OF APPELLANT, A. BATES BUTLER, ON CROSS-APPEAL OF THE BANK OF TUCSON

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REPLY TO ANSWERING BRIEF OF APPELLEES, PACIFIC NATIONAL INSURANCE COMPANY AND MARTIN CONSTRUCTION COMPANY AND OF APPELLANT, A. BATES BUTLER, ON CROSS-APPEAL OF THE BANK OF TUCSON

A R G U M E N T

It is obvious from the previous briefs filed herein on the Bank's cross-appeal that there is a split of authority as to the allowance as attorneys' fees of a specific percentage or amount stipulated in a promissory note.

As previously pointed out by the cross-appellant Bank, in its Opening Brief on Cross-Appeal, the Supreme Court of the State of Arizona in several cases, notably, Mayo v. Ephrom, 84 Ariz. 169, 325 P.2d 814, and Pioneer Construction v. Symes, 77 Ariz. 107, 267 P.2d 740, has adopted the rule that in the absence of a tender of an issue

of unreasonableness of the stipulated percentage and the introduction by the defendant of evidence of unreasonableness, the stipulated percentage of the amount found to be due upon a promissory note should be allowed as attorneys' fees. As has been pointed out by cross-appellee Trustee in his Opening Brief, the law of the State of Arizona is governing here. Erie Railroad v. Thompkins, 304 US 64, 58 S. Ct. 817, 82 L.Ed. 1188; Adelman v. Centaur Corp., (CCA Ohio) 145 F.2d 573. Therefore, if Arizona still follows the rule above set forth, the judgment of the District Court that ten (10%) per cent of the amount found to be due the Bank ($25,169.26, together with interest thereon at 6% from December 12, 1963) is unreasonable and failing to allow such sum is obviously error, its

judgment must, to that extent, be reversed and the Bank must be allowed that amount as its attorneys' fees.

The answer of the Trustee cites an Idaho case and a Texas case to support his position. These cases are, of course, not persuasive as the Arizona Supreme Court has already spoken in this matter as above noted, and its law must be followed.

The appellees Pacific and Martin cite the recent case of Elson Development Co. v. Arizona Savings and Loan Association, 99 Ariz. 217, 407 P.2d 930, for the proposition that Arizona has now adopted the rule that the payee of a note must introduce affirmative evidence of the reasonableness of a stipulated attorney's fee to recover. This is not the holding of the Elson case.

Elson Development (supra) was an appeal from a summary judgment granted the payee of a promissory note against the maker. The stipulation in the promissory note did not state a specific amount or percentage as attorneys' fees, but rather provided for a "... reasonable sum(not less than three (3%) per cent nor more than four (4%) per cent....." Elson Development Co. v. Arizona Savings and Loan Association (supra). Therefore, to begin with, the Court in that case was not dealing with a specific percentage provision, but only with a reasonable percentage, in which case some evidence must be introduced upon which the Court could grant attorneys' fees. Therefore, the case is not at all in point.

Secondly, in Elson, the

defendant-maker had answered denying that the amount alleged to be reasonable by the plaintiff-payee in his complaint was reasonable and affirmatively specifically alleged that it was unreasonable, setting forth a specific much lower amount which was alleged to be the maximum reasonable amount. The plaintiff-payee moved for and was granted summary judgment on these facts.

The Court held that:

> "The agreement in the instant case which provided for a reasonable sum - not less that three per cent nor more than four per cent - was indefinite as to the exact amount between three per cent and four per cent which would be reasonable. ... Under the holding of this Court in Crouch v. Pixler, supra, evidence was required to determine the amount of a reasonable attorneys fees." Elson Development Co. v. Arizona Savings and Loan Association (supra)

Obviously then, the Court was merely holding that where the issue of unreasonableness was raised, and where the amount stipulated was indefinite, there was a fact issue which would preclude the Court from properly granting a motion for summary judgment.

The Court in the Elson Development case not only did not overrule the cases cited by Bank in its Opening Brief but stated as follows:

> "This Court has long recognized the right of parties to a note to agree on the amount of attorney's fees, by providing that the same shall be fixed at a reasonable amount. ...a definite percentage of the amount recovered or a specific amount." Elson Development Co. v. Arizona Savings and Loan Association (supra)

The last contention of cross-appellees Pacific and Martin is patently invalid. It is obvious

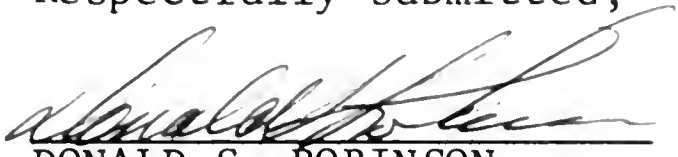
from the face of the pleadings, findings and judgment that not only did Bank place the promissory note in the hands of an attorney for collection but that it did collect the balance due thereunder, $26,169.20 plus interest. Cross-appellees can, then, hardly contend the note was not placed in an attorney's hands for collection.

C O N C L U S I O N

In conclusion, it appearing again that Arizona has adopted the rule that a stipulation for a specific percentage of a promissory note to be allowed as attorneys' fees must be honored by the Court in the absence of evidence of the unreasonableness thereof, and that such rule is still the law of the State of Arizona and there having been

no evidence whatsoever of the unreasonableness of the stipulation for attorneys' fees in the promissory note in the instant case of ten (10%) per cent of the amount found to be due, it was clearly error for the District Court to find that such an amount was unreasonable and to fail to allow the Bank that amount as its attorneys' fees. The judgment should be reversed to that extent.

Respectfully submitted,



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I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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Nos. 20,391, 20,392 and 20,393

IN THE

United States Court of Appeals

For the Ninth Circuit

DONALD SCOTT, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 20391
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ESTATE OF BURT EDSALL, Deceased, MARY E. EDSALL, Executrix, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 20393

Appeal from the Judgment of the Tax Court of the United States
Honorable Craig S. Atkins, Judge

PETITIONERS' OPENING BRIEF

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Nos. 20,391, 20,392, 20,393

IN THE

United States Court of Appeals

For the Ninth Circuit

DONALD SCOTT, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 20391
ROBERT SCOTT, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 20392
ESTATE OF BURT EDSALL, Deceased, MARY E. EDSALL, Executrix, *Petitioner,* vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 20393

Appeal from the Judgment of the Tax Court of the United States Honorable Craig S. Atkins, Judge

PETITIONERS' OPENING BRIEF

JURISDICTION

This is an appeal, or petition of review, from the decision of the Tax Court of the United States up-

holding a determination by the Commissioner of Internal Revenue of estate tax deficiency in the Estate of Raymond R. Scott, deceased.

Petitions of Redetermination were timely filed with the Tax Court of the United States on May 28, 1963, for review of the Decision of the Commissioner of Internal Revenue. (Trans. of Rec. pages 1 and 10.) A Petition of Review of the three cases herein consolidated was timely filed before this Court on August 5, 1965 (Trans. of Rec. pages 160 and 176), pursuant to Internal Revenue Code, Section 7483. This Court has jurisdiction to review the judgment of the Tax Court under and by virtue of Section 7482 of the Internal Revenue Code.

STATEMENT OF THE CASE

The following facts were submitted by stipulation before the Tax Court:

The decedent, Dr. Raymond R. Scott, a resident of California, died testate on December 1, 1958. His wife, Ruth Scott, died testate on October 28, 1957. Sometime prior to decedent's marriage to Ruth Scott on June 11, 1928, he took out two (2) life insurance policies on his own life. After their marriage, and while living in California, the decedent purchased with community funds eight (8) more insurance policies on his life. After their marriage all premiums paid on all policies were from community funds. (Trans. of Rec. pages 55-56.)

On the day that Ruth Scott executed her Last Will, namely September 20, 1957, she wrote a letter to her two sons, Donald Scott and Robert Scott, concerning the life insurance policies which expressed her concern over continuance of the payment of premiums in the event of her death prior to that of her husband, Dr. Raymond R. Scott. (See Exhibit 4-D to Stipulation of Facts.) (Trans. of Rec. page 98.)

At the time of her death, Ruth Scott was the primary beneficiary on each policy and the Scotts' two children, Donald and Robert, were contingent beneficiaries. (Trans. of Rec. page 56.)

By her Will, Ruth Scott bequeathed all of her community interest in her husband's medical practice to her husband, the decedent, and bequeathed the rest, residue and remainder of her estate to Robert and Donald Scott. (Trans. of Rec. page 94.) Her estate was probated in Fresno County, California. On June 23, 1958, the Estate of Ruth Scott filed a Federal Estate Tax Return with the District Director of Internal Revenue at San Francisco, California. Therein the executor of her estate did not include in the gross estate any amount on account of the life insurance policies.

In 1959, following the decision in *United States v. Stewart* (C.A. 9), 270 F. 2d 894, the executor of the Estate of Ruth Scott agreed with the District Director of Internal Revenue that an amount of $15,946.76 (equal to one-half of the cash surrender value of the life insurance policies as of the date of Ruth Scott's death) was properly includible in her gross estate.

The executor caused to be paid the additional estate tax resulting from such inclusion. (Trans. of Rec. page 56.)

At some time after the death of Ruth Scott, the decedent changed the insurance policies by designating Robert and Donald Scott as primary beneficiaries. (Trans. of Rec. page 57.)

During the period between the death of the decedent's wife and the death of the decedent, premiums of $4,550.68 became due and payable on the policies. Of this amount $2,702.30 was paid by Donald and Robert from that portion of their mother's estate to which they were entitled as legatees. These payments were made by Donald and Robert to prevent the policies from lapsing since the decedent was not in a position to make, or did not make, the necessary payments when they came due. (Trans. of Rec. page 57.)

Two months prior to his death, the decedent borrowed from the life insurance company $11,495.05 on one of the policies of insurance on his life, receiving a check therefor. However, this check was not cashed prior to the decedent's death. (Trans. of Rec. page 57.)

The decedent's estate was probated in Fresno County, California. The decedent's estate tax return was filed on February 29, 1960, with the District Director of Internal Revenue at San Francisco, California. In the estate tax return the executor included in the gross estate the amount of $57,173.43 purporting to represent one-half of the insurance receivable by beneficiaries, other than the decedent's estate,

under policies on the life of the decedent. The respondent determined (and the parties agree) that the amount of insurance so receivable was $115,474.48 (being the face amount of the policies, less amounts borrowed against the policies, including the amount of $11,495.05 borrowed by the decedent two months prior to his death). He then determined that that amount, less, however, the amount of $15,946.76 which had been previously included in the deceased wife's gross estate, or a net amount of $99,527.72, should be included in the decedent's gross estate. Since there had been included in the return on account of the policies an amount of $57,173.43, the net increase determined by the respondent in this respect was $42,-354.29.

In the estate tax return there was included in the gross estate the amount of $5,757.52, representing one-half of the amount borrowed by the decedent, and represented by the check which the decedent had not cashed. In determining the deficiency the respondent included in the gross estate the entire amount of $11,-495.05.

In determining the deficiency the respondent treated the amount of premiums paid by Donald and Robert Scott, $2,702.30, as debts of the decedent and allowed such amount as a deduction in computing the taxable estate.

After the death of the decedent the proceeds of all the insurance policies, as well as the other assets of the decedent's estate, were distributed to the beneficiaries, Donald and Robert Scott.

SPECIFICATION OF ERROR

Petitioners contend that the judgments appealed from are not in accord with law in that the Tax Court erred in holding that all of the proceeds of the ten (10) life insurance policies insuring the life of decedent, Raymond R. Scott, to-wit, $115,474.48, less $15,946.76 previously included in the gross estate of the predeceased spouse, Ruth Scott, were includible in the gross estate of said decedent for federal estate tax purposes, and that the Travelers Life Insurance Company check in the amount of $11,495.05 was wholly includible in said decedent's gross estate; whereas only one-half of the proceeds of the said insurance policies and one-half of said check should have been included in the gross estate of said decedent for estate tax purposes.

ARGUMENT

Petitioners respectfully submit that the law of the State of California is controlling in determining the character, nature and quality of property bequeathed or devised and that the subject life insurance policies were community property of Raymond R. Scott and Ruth Scott and that the Travelers Life Insurance Company check was attributable thereto; petitioners submit that at the time of his death, Raymond R. Scott had incidents of ownership in only one-half of said policies and had only a one-half interest in the subject check, that the community property interest of Ruth Scott in said insurance policies was willed by her and distributed from her estate to her sons,

Donald Scott and Robert Scott, and that her said sons owned one-half of the policies, the check and their entitlements on the date of death of Raymond R. Scott.

I.

The nature, character and quality of devised property for estate tax purposes is dependent upon local law. The question of whether the interest of the wife in her husband's life insurance policies is includible in her estate for tax purposes is controlled and determined by state law.

U. S. v. A. O. Stewart, 270 Fed. 2d 894;
Blair v. Commissioner of Internal Revenue, 300 U. S. 5;
Poe v. Seaborn, 282 U. S. 101;
Lang v. Commissioner of Internal Revenue, 304 U. S. 264.

II.

Under California law, an insurance policy is property. It can be sold, assigned or bequeathed by the owner thereof. Its extrinsic value to the owner is as great as though he held a promissory note of the insurance company payable upon the event of death. It is a chose in action which is satisfied upon payment to the owner thereof—title to the proceeds following title to the policy.

Blethen v. Pacific Mutual Life Insurance Co., 198 Cal. 91, 98, 243 Pac. 431;
In re Dobbel, 104 Cal. 432, 38 Pac. 87;
California Insurance Code, § 10130;
10 *Cal. Jur.* 2d 695.

In California, when property is acquired during a marriage with community funds, the same constitutes community property. Likewise, the rents, issues and profits of community property are community in character.

California Civil Code, §§ 162, 163 and 164;
Boyd v. Oser, 23 Cal. 2d 613, 621, 145 Pac. 2d 312.

An insurance policy insuring the life of the husband is community property if the premiums have been paid for out of community funds and by the same token, "the proceeds of an insurance policy, the premiums on which have been paid out of community assets, are community property . . ."

Blethen v. Pacific Mutual Life Insurance Co., 198 Cal. 91, 99, 243 Pac. 431;
New York Life Insurance Co. v. Bank of Italy, 60 Cal. App. 602, 214 Pac. 61;
Union Mutual Life Insurance Co. v. Broderick, 196 Cal. 497, 238 Pac. 1034;
Travelers Insurance Co. v. Fancher, 219 Cal. 351, 26 Pac. 2d 482;
Grimm v. Grimm, 26 Cal. 2d 173, 157 Pac. 2d 841;
Witkin, *Summary of California Law of Community Property,* Section 152(a);
9 *Stanford Law Review* 239.

III.

Prior to 1927 the decisions of the California Courts indicated that the wife had only an "expectancy" in

community assets; however, in 1927 the legislature enacted California Civil Code § 161(a)[1] which has been accepted as establishing that the wife has a "vested" interest in community property. The wife's community property interest, subject to administration, belongs to her and "never did belong to the husband".

Estate of King, 19 Cal. 2d 354, 363, 121 Pac. 2d 716;

Estate of Kelley, 122 Cal. App. 2d 42, 264 Pac. 2d 210.

During her life the wife may sell or assign her community property interests to whomever she may choose. By a like token, she may upon her death devise or bequeath her share of the community property.[2]

> "In the State of California a wife has a one-half interest in community property. It is true the husband retains possession and control of community personal property (Calif. Civil Code 172) but the husband cannot devise the wife's interest

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[1]California Civil Code, § 161(a):

"The respective interests of the husband and wife in community property during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in Sections 172 and 172(a) of the Civil Code. This section shall be construed as defining the respective interests and rights of husband and wife in the community property."

[2]California Probate Code, § 201:

"Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse, subject to the provisions of Sections 202 and 203 of this code."

in community property, either real or personal (California Probate Code § 201, 201.5). *She has such an interest in community property that it is possible for her to will away her portion thereof and thus, at her death, cause a division of the community estate.* (Probate Code §202)". (Emphasis added.)

California Trust Company v. Riddell, 136 Fed. Sup. 7.

IV.

Life insurance policies as items of community property are subject to the same rules pertaining to other community property.

New York Life Insurance Co. v. Bank of Italy, 60 Cal. App. 602, 606, 214 Pac. 61;

Blethen v. Pacific Mutual Life Insurance Co., 198 Cal. 91, 243 Pac. 431.

"We find nothing in California law which indicates that life policies as items of community property are treated by rules other than or different from those pertaining to community property generally".

U. S. v. A. O. Stewart, 270 Fed. 2d 894.

A life insurance policy occupies no different position than any other form of property and may be sold or assigned by the owner thereof.

See

California Insurance Code, Section 10130;

Esswein v. Rogers, 216 Cal. App. 2d 91, 30 Pac. 2d 738.

If the California statutory law in California Civil Code Section 161(a) and California Probate Code 201 is to be given the meaning which its language requires, those who succeed to the wife's community property interests, by virtue of her Will, must succeed to whatever interest she had at the time of her death; nothing less and nothing more. With respect to each community asset, the legatee acquires equal status and the interest obtained through inheritance is neither diminished nor enlarged. The Tax Court's holding has the effect of causing a severe loss in the process of testamentary disposition. Ruth Scott, at the time of her death, had a community one-half vested interest in the subject policies. If her legatees succeeded to an interest in only one-half the cash surrender value of these policies as the Tax Court holds, something material vanished in the process. The California wife has, without due process, been deprived of her property and the right of testamentary disposition of her entire estate. Such is not the law in this state.

V.

The 1960 decision of the Fourth District Court of Appeals of the State of California in the case of *Estate of Mazie O. Mendenhall, Deceased,* 182 Cal. App. 2d 441, 6 Cal. Rptr. 45, is the only California Court decision directly on point with the case at bar and is fully in accord with petitioners' position. The Court therein states that the wife may by her Will dispose of her interest in community life insurance policies on the life of her husband and that her rep-

resentatives and beneficiaries under her Will succeed to her exact and same position and interest therein.

In *Estate of Mazie O. Mendenhall, supra,* the facts are almost identical as in the subject case. The husband and wife had procured insurance policies on the life of the husband and had paid the premiums thereon out of community funds. The same contractual rights in the policies were given to the husband as in our subject case. There were twelve (12) policies involved. The insurance policies were payable to the husband's estate. The wife died first and under her Will she made certain small and specific bequests. These bequests included the giving to her husband personal effects, home furnishings and an automobile, and also the giving of a $1,000.00 charitable bequest. All of the rest and residue of the estate was left by her to a trust. She made no specific reference in her Will to the life insurance nor to any other specific property except as above mentioned. The question before the Court was whether the deceased spouse could by her Will give to her testamentary trust one-half interest in these insurance policies. The Appellate Court expressly held that *her one-half interest in the insurance policies* went under the provisions of her Will to the trust and, therefore, *"her one-half interest in the insurance policies should have been inventoried as part of her estate"*. As was stated at pages 444 through 447:

> "An insurance policy paid for from community funds is ordinarily community property (Estate of Allie, 50 Cal. 2nd 794, 798 (3) (329 P. 2nd 903); Grimm v. Grimm, 26 Cal. 2nd 173, 175 (1)

(157 Pac. 2nd 841); New York Life Ins. Co. v. Bank of Italy, 60 Cal. App. 602, 606 (214 P. 61); Bazzell v. Endriss, 41 Cal. App. 2nd 463, 464 (1) (107 P. 2nd 49); Cook v. Cook, 17 Cal. 2nd 639, 644 (1) (111 Pac. 2nd 322) . . ."

"Since the insurance premiums here involved were all paid from community funds, and there is no suggestion that any were paid prior to 1927, there is no question but that the wife's interest was 'present, existing and equal' and was a vested interest and that she has equal testamentary power with the husband. (Odone v. Marzocchi, 34 Cal. 2nd 431, 439 (13) (211 P. 2nd 297, 212 P. 2nd 233, 17 A.L.R. 2nd 1109); Horton v. Horton, 115 Cal. App. 2nd 360, 364 (1) (252 Pac. 2nd 397) . . ."

"Mere acquiescence by a dutiful wife to the legal right of the husband to manage and control the community personal property cannot give rise to a presumption that she agreed to surrender her community interest. The fact that he named his estate as beneficiary would give no right of action to the wife until his death. She could, of course, give notice to the insurance company of her community claim, thereby preventing payment of her half interest to a third party, but she could not disturb the policy during the husband's lifetime. (Beemer v. Roher, 137 Cal. App. 293, 294 (5) (30 Pac. 2nd 547); Berniker v. Berniker, supra.) Even after his death, she would still retain her community interest. (New York Life Ins. Co. v. Bank of Italy, supra.) When the husband names his estate as beneficiary, it will not be presumed that he intended to change the character of the property from community to separate (Estate of

> Castagnola, 68 Cal. App. 732, 737 (5) (230 Pac. 188); Estate of Wedemeyer, 109 Cal. App. 2nd 67, 71 (6) (240 Pac. 2nd 8).) Since she chose to dispose of her right by Will, her representatives would succeed to her rights . . ."
>
> "We merely hold that the wife's unwritten acquiescence in the naming of the husband's estate as the beneficiary did not deprive her of her community interest therein, and since she did by Will devise her estate to others than her husband, *her one-half interest in the insurance policies should have been inventoried as a part of her estate* for general inheritance tax purposes." (Emphasis added.)

VI.

In the case at bar, the Tax Court erroneously held that the value of the wife's one-half interest in the insurance policies consisted of only the cash surrender value thereof at the time of her death.[3] The confusion arises by a failure of the Tax Court to recognize that an insurance policy is property, the same as a promissory note, contract or chose in action. The confusion arises by a failure to differentiate between the asset and the value of the asset. The discount value of a note is not the note itself. The marketable value of an executory contract is not the contract itself. The

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[3]In valuing the property interest of Ruth Scott in the life insurance policies as of the time of her death for federal estate tax purposes, it was agreed by the executor of Mrs. Scott's estate that an amount equal to one-half of the then existing cash surrender value should be included in the gross estate value. This was considered a fair basis for establishing the value of such interest in line with the decision of *California Trust Company v. Riddell,* supra, and *U. S. v. A. O. Stewart,* 270 Fed. 2d 894.

value of a share of stock is not the interest in the corporation. The fair market value or cash surrender value of an insurance policy is not the insurance contract.

To hold that the wife cannot bequeath her entire community property one-half interest in an insurance policy is abitrary and grossly unjust. If she has no right to bequeath her entire interest, then her husband may effectively deprive her of her property. The insurance policy interest of the wife may have a much greater personal value to her, or to the person to whom she might transfer, assign or bequeath the same, than its then marketable value. To hold that she cannot bequeath her interest in its entirety is to inform her that she must sell, assign or transfer her property, other than by Will, in order to realize the benefits of her labor; and is to inform her that she cannot of her own volition give to her issue the protection and safeguards they deserve. If the wife has no right to bequeath her entire interest, then a husband may with impunity invest the community fortune in insurance policies and thereby deprive her of the fruits of her labor.

CONCLUSION

There is no legal or logical basis upon which one could assert that the wife's community interest in life insurance policies on the life of her surviving husband at the time of her death is merely their value at the time of her demise. This would be a unique theory of making the value of an asset the whole commodity which the deceased may dispose of rather than the asset itself; this would be entirely inconsistent with the law in California or elsewhere, and also, if entertained as to deceased wife's community interest in life insurance contracts on her surviving husband, would contradict the very reasoning by all Courts for including this community interest in the wife's gross estate, which reasoning is that such community interest in the policies are the same as any other community interest and, therefore, subject to the same laws applicable to other community interests on her demise.

Therefore, at the time of the death of Raymond R. Scott, the two sons, Robert and Donald Scott, had the same interest their mother had in the subject life insurance contracts by reason of testamentary gift thereof from Ruth Scott which was received by them under the distribution clause in the Decree of Distribution rendered by the Probate Court in the probate of her Will. Consequently, only one-half of said insurance contracts and half their entitlements are includible in the gross estate of Raymond R. Scott, and since the same principles are applicable to the subject check, only one-half thereof is includible in the gross estate of Raymond R. Scott.

It is respectfully submitted that a reversal of the Tax Court's decision in this case is essential if the logic of the California community property law is to be preserved and if the right of testamentary disposition of community property is to remain a meaningful right to the California wife.

WILD, CHRISTENSEN, CARTER & BLANK,
By ROBERT G. CARTER,
Attorneys for Petitioners.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing is in full compliance with those rules.

ROBERT G. CARTER,
Attorney.

I certify that a copy of the above and foregoing Brief was this date deposited in the United States Mail, postage prepaid, in a cover addressed to Melvin L. Sears, Regional Counsel, U. S. Treasury Department, Internal Revenue Service, Room 628, 447 Sutter Street, San Francisco, California.

Dated at Fresno, California, this 14th day of March, 1966.

ROBERT G. CARTER,
Attorney.

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Respondent

ROBERT SCOTT,

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ESTATE OF BURT EDSALL, Deceased,
MARY E. EDSALL, Executrix,

Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent

ON PETITIONS FOR REVIEW OF THE DECISIONS OF THE
TAX COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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BRIEF FOR THE RESPONDENT

OPINION BELOW

The opinion of the Tax Court (R. 160-172) is reported at 43 T.C. 920.

JURISDICTION

The Commissioner of Internal Revenue, under date of February 28, 1963, notified Donald Scott, Robert Scott, and the Estate of Burt Edsall, deceased (petitioners herein), by certified mail (R. 10-13,

28-31, 46-49) of his determination that they were each liable, Donald and Robert Scott as transferees and beneficiaries, and the Estate of Burt Edsall, deceased, of his liability under Section 6213 of the Internal Revenue Code of 1954, as executor of the estate, for additional federal estate taxes determined to be due and owing from the estate of Raymond R. Scott, deceased, in the sum of $10,400.81. Donald Scott, Robert Scott, and the Estate of Burt Edsall each filed a timely petition with the Tax Court on May 28, 1963 (R. 1-9, 19-27, 37-45), for redetermination of their liability. On May 5, 1965, the Tax Court entered its decisions (R. 173-175) affirming the Commissioner's determination in each case. Petitions for review of the Tax Court's decisions by this Court (R. 176-195) were duly filed on August 4, 1965, within the three-month period prescribed in Section 7483 of the Internal Revenue Code of 1954. Jurisdiction is conferred on this Court by Section 7482 of the Internal Revenue Code of 1954.

QUESTION PRESENTED

Whether the Tax Court erred in holding that for purposes of the federal estate tax there should be included in the value of the gross estate of the decedent, who died a resident of the State of California, (1) the full amount of proceeds payable under certain policies of insurance on the life of the decedent which had been purchased with community funds, less one-half of the cash surrender value of such policies at the date of the prior death of his wife which had been included in her estate tax return for federal estate tax purposes, instead of only one-half of the proceeds of such policies as contended by the petitioners, and (2) the full amount of a check

representing a loan obtained by the decedent on one of the policies, which was received by the decedent prior to his death but never cashed, instead of only one-half of such loan as contended by the petitioners.

STATUTE AND REGULATIONS INVOLVED

The pertinent provisions of the Internal Revenue Code of 1954 and Treasury Regulations thereunder are printed in the Appendix, infra.

STATEMENT

The Commissioner of Internal Revenue determined that there was a deficiency in estate tax in the amount of $10,400.81 due from the Estate of Raymond R. Scott, deceased. He determined that Donald Scott and Robert Scott is each liable as transferee and beneficiary of the estate for the full amount of the deficiency, and also determined that the Estate of Burt Edsall is liable for the full amount of the deficiency for which Burt Edsall became personally liable as executor, under Sections 6901 and 6324 of the Internal Revenue Code of 1954. (R. 161.) The Commissioner's statutory notices of such determination (R. 10-13, 28-31, 46-49) were made the basis of petitions for redetermination of such liabilities (R. 1-9, 19-27, 37-45) filed with the Tax Court. The liability of the respective petitioners for any additional tax due from the Estate of Raymond R. Scott is not questioned (R. 162); only the correctness of the Commissioner's determination of such estate tax liability is in issue.

The facts were stipulated (R. 54-58), supplemented by documentary evidence (R. 59-127), and are not in dispute. They are summarized in the Tax Court's opinion substantially as follows (R. 162-165):

Raymond R. Scott, herein referred to as the decedent, was a resident of California. He died testate on December 1, 1958. His wife, Ruth Scott, died testate on October 28, 1957. (R. 162.)

Sometime prior to his marriage to Ruth Scott on June 11, 1928, the decedent took out two life insurance policies on his own life. After their marriage, and while living in California, the decedent purchased with community funds eight more insurance policies on his life. After their marriage all premiums paid on policies were from community funds. (R. 162.)

At the time of her death, Ruth Scott was the primary beneficiary on each policy and the Scotts' two children, Donald and Robert, were contingent beneficiaries. (R. 162.)

By her will, Ruth Scott bequeathed all of her community interest in her husband's medical practice to her husband, the decedent, and bequeathed the rest, residue, and remainder of her estate to Robert and Donald Scott. Her estate was probated in Fresno County, California. On June 23, 1958, the Estate of Ruth Scott filed a federal estate tax return with the District Director of Internal Revenue at San Francisco, California. Therein the executor of her estate did not include in the gross estate any amount on account of the above life insurance policies. (R. 162-163.)

In 1959, following the decision of this Court in United States v. Stewart, 270 F. 2d 894, certiorari denied, 361 U.S. 960, the executor of the Estate of Ruth Scott agreed with the District Director of Internal Revenue that an amount of $15,946.76 (equal to one-half of the cash surrender value of the life insurance policies as of the date

of Ruth Scott's death) was properly includible in her gross estate. The executor caused to be paid the additional estate tax resulting from such inclusion. (R. 163.)

At some time after the death of Ruth Scott, the decedent changed the insurance policies by designating Robert and Donald Scott as the primary beneficiaries. (R. 163.)

During the period between the death of the decedent's wife and the death of the decedent, premiums of $4,550.68 became due and payable on the policies. Of this amount $2,702.30 was paid by Donald and Robert from that portion of their mother's estate to which they were entitled as legatees. These payments were made by Donald and Robert to prevent the policies from lapsing since the decedent was not in a position to make, or did not make, the necessary payments when they came due. (R. 163.)

Two months prior to his death the decedent borrowed from the life insurance company $11,495.05 on one of the policies of insurance on his life, receiving a check therefor. However, this check was not cashed prior to the decedent's death. (R. 163.)

The decedent's estate was probated in Fresno County, California. The decedent's estate tax return was filed on February 29, 1960, with the District Director of Internal Revenue at San Francisco, California. In the estate tax return the executor included in the gross estate the amount of $57,173.43 purporting to represent one-half of the insurance receivable by beneficiaries, other than the decedent's estate, under policies on the life of the decedent. The Commissioner determined (and the parties agree) that the amount of insurance so receivable was $115,474.48 (being the face amount of the policies,

less amounts borrowed against the policies, including the $11,495.05 borrowed by the decedent two months prior to his death.) He then determined that that amount, less, however, the amount of $15,946.76 which had been previously included in the deceased wife's gross estate, or a net amount of $99,527.72, should be included in the decedent's gross estate. Since there had been included in the return on account of the policies an amount of $57,173.43, the net increase determined by the Commissioner in this respect was $42,354.29. (R. 164.)

In the estate tax return of the decedent there was included in the gross estate the amount of $5,747.52, representing one-half of the amount borrowed by the decedent, evidenced by the check which the decedent had not cashed. In determining the deficiency the Commissioner included in the gross estate the entire amount of $11,495.05. (R. 164.)

In determining the deficiency, the Commissioner treated the amount of premiums paid by Donald and Robert Scott, $2,702.30, as a debt of the decedent and allowed such amount as a deduction in computing the taxable estate. (R. 164-165.)

After the death of the decedent the proceeds of all of the insurance policies, as well as the other assets of the decedent's estate, were distributed to the beneficiaries, Donald and Robert Scott. (R. 165.)

The Tax Court sustained the Commissioner's determination (R. 165-172), and these appeals followed.

SUMMARY OF ARGUMENT

The decedent herein died testate, a resident of the State of California, having been predeceased by his wife, who also died testate. At the time of the wife's prior death there were outstanding ten policies

of insurance on the life of the decedent, the premiums on which had been paid with community funds. The wife's death dissolved the marital community under California law. By her will, the wife devised and bequeathed to their two sons all the rest, residue and remainder of her estate, which included her one-half community property interest in the insurance policies on the life of the decedent, and it was determined that the value of her one-half community property interest in such policies for federal estate tax purposes was equal to one-half of the cash surrender value at the date of the wife's prior death.

Upon the subsequent death of the surviving husband, the decedent here, the proceeds of the policies in issue became payable to their sons as named beneficiaries, having been so designated by the decedent after the death of his wife. Accordingly, no question could arise under California law as to what portion of such proceeds represented the community property interest of their mother in such policies which passed to them under the mother's will. Admittedly, however, the community property interest of the deceased wife in such policies which passed to the sons under her will should be excluded from the gross estate of the decedent in valuing his estate for federal estate tax purposes. In the absence of a more acceptable method of determining the value of the community property interest of the wife in such policies which passed at her death, the Commissioner of Internal Revenue determined such value to be equal to one-half of the cash surrender value of the policies at the date of her death, and determined the estate tax liability of the decedent's estate by including in the

value of his gross estate the net amount of proceeds payable to the beneficiaries under the policies in issue, less one-half of the cash surrender value of the policies at the date of the wife's prior death.

This Court has already held, for federal estate tax purposes, that one-half of the cash surrender value at the date of her death represents the value of the community property interest of a deceased wife in policies of insurance on the life of her husband which, so far as the Court's opinion shows, passed to the surviving husband upon the death of the wife, and one California District Court of Appeal has approved, for state inheritance tax purposes, the same method of determining the value of the deceased wife's community property interest in policies on the life of her surviving husband which passed to others under her will. Also, in the present case, the executor of the deceased wife's will agreed to the inclusion in her gross estate, as the value of the wife's community property interest in the policies here in issue passing to the beneficiaries under her will, one-half of the cash surrender value of such policies at the date of her death. Under the circumstances, we submit that the Commissioner and the Tax Court did not err in excluding from the proceeds payable under the policies in issue, as representing the value of the wife's one-half interest therein passing to others at the time of her death, only one-half of the cash surrender value of such policies at the date of her death.

The petitioners contend, on the other hand, that the deceased wife made testamentary disposition of one-half of the proceeds which later became payable under the policies on the death of the decedent

and that only the other one-half of the proceeds are includible in the decedent's gross estate. Petitioners cite no authority to support this proposition, and we know of none. Under California law, the spouse who dies first can dispose of only one-half of the community property by will. At the death of a non-insured spouse the material community has only a potential right to the proceeds of insurance on the life of the survivor. The only right of the marital community to proceeds of insurance on the life of the survivor is to proceeds payable on surrender of the policy. Policy-rights and proceed-rights are not to be confused. The federal estate tax, as applicable here, is based upon the right to receive the proceeds of insurance on the life of the decedent payable to beneficiaries other than his estate. That right ripens with his death, and in the absence of statute or decisional support for holding that the non-insured member of the marital community can by will bequeath one-half of the proceeds payable under policies on the life of the insured member of the marital community, as distinguished from the policy rights of the community existing at the time of such prior death, there is no basis for excluding one-half of the proceeds payable on the survivor's death in determining the value of his estate for federal estate tax purposes.

ARGUMENT

THE TAX COURT CORRECTLY HELD THAT THE AMOUNT OF THE PROCEEDS OF CERTAIN INSURANCE POLICIES ON THE LIFE OF THE DECEDENT, THE PREMIUMS ON WHICH HAD BEEN PAID WITH COMMUNITY FUNDS UNTIL PRIOR DEATH OF HIS WIFE, LESS ONE-HALF OF THE CASH SURRENDER VALUE OF SUCH POLICIES AT THE DATE OF THE PRIOR DEATH OF HIS WIFE, AND THE FULL AMOUNT OF A LOAN OBTAINED ON SUCH POLICIES JUST PRIOR TO HIS DEATH, ARE INCLUDIBLE IN THE GROSS ESTATE OF THE DECEDENT

At the time of his death on December 1, 1958, the decedent held ten policies of insurance on his life, the proceeds of which were payable to beneficiaries other than his estate. Until the prior death of his wife, who predeceased him testate on October 28, 1957, the premiums on those policies had been paid out of community funds, and one-half of the cash surrender value of such policies at the date of her death was properly included in her gross estate for federal estate tax purposes. United States v. Stewart, 270 F. 2d 894 (C.A. 9th), certiorari denied, 361 U.S. 960. Upon the death of the decedent there was paid to the beneficiaries named in the policies a net amount of $115,474.48 (the face amount of the policies less loans outstanding against them (R. 69-70)), and the principal issue involved on this appeal is whether the amount of such proceeds, less one-half of the cash surrender value at the date of the prior death of the wife ($15,946.76), is properly includible in the value of his gross estate for federal estate tax purposes.

Section 2001 of the Internal Revenue Code of 1954 (Appendix, infra) imposes a graduated estate tax upon "the transfer of the taxable estate, determined as provided in section 2051, of every decedent, citizen or resident of the United States dying after the date of

enactment of this title." Section 2031 of the 1954 Code (Appendix, infra) provides that "The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated", and Section 2051 (Appendix, infra) provides that "For purposes of the tax imposed by section 2201, the value of the taxable estate shall be determined by deduction from the value of the gross estate the exemption and deductions provided for in this part."

Applicable here are Section 2033 of the 1954 Code (Appendix, infra), which provides that "The value of the gross estate shall include the value of all property * * * to the extent of the interest therein of the decedent at the time of his death", and more particularly Section 2042 (Appendix, infra), which provides that "The value of the gross estate shall include the value of all property -- (1) * * * To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent", and "(2) * * * To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person." (Emphasis supplied.)

The insurance policies here in issue were payable to beneficiaries other than the estate of the decedent, and with respect to such policies Treasury Regulations on Estate Tax (1954 Code) provide in Section 20. 2042-1(c) (Appendix, infra), in part--

> (2) For purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. Similarly, the term includes a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder.
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> * * *
>
> (5) As an additional step in determining whether or not a decedent possessed any incidents of ownership in a policy or any part of a policy, regard must be given to the effect of the State or other applicable law upon the terms of the policy. * * *

In this case, after the death of his wife the decedent had, so far as the present record shows, all of the incidents of ownership of the policies in issue, including the right to assign and revoke assignment of the policies, the right to change the beneficiaries, pledge them for a loan or obtain loans against the surrender value of the policies, and surrender the policies, limited only by the right of legatees under his wife's will to claim her community interest at the time of her death. Possessing, as he did, all these incidents of ownership at the time of his death, the value of his interest in the policies at the date of his death, includible in gross estate under the general provisions of Section 2033 of the 1954 Code, was the amount payable under the policies less the amount which the beneficiaries under the deceased wife's will could claim as her community interest in the policies which passed to them under the will. Applying this same limitation to policies of insurance on the life of the decedent payable to beneficiaries other than the estate

of the decedent, specifically included in gross estate by Section 2042 of the 1954 Code, the Tax Court properly held that the entire proceeds payable under the policies upon the decedent's death, less the wife's one-half community interest therein, measured by the cash surrender value of the policies at the date of her death, are includible in the decedent's gross estate.

The interest of the decedent and his wife in the policies here in issue was community property at the date of the wife's death under California law, and under the Civil Code, 6 West's Annotated California Codes, Section 161a, the respective interest of the husband and wife in community property "during continuance of the marriage relation are present, existing and equal interests under the management and control of the husband as is provided in sections 172 and 172 of the Civil Code." 1/ The prior death of the wife dissolved the marriage relation, and under the California Probate Code, 52 West's Annotated California Codes, Section 201, "Upon the death of either husband or wife, one-half of the community property belongs to the surviving spouse; the other half is subject to the testamentary disposition of the decedent, and in the absence thereof goes to the surviving spouse, subject to the provisions of sections 202 and 203 of this code."

1/ The community property interest of the wife in an insurance policy on the life of her husband, whatever else it may be, definitely is not, notwithstanding the petitioners' intimation to the contrary (Br. 7), the interest of an owner of the policy. The policy, as such, is only a document setting forth the terms and conditions of a contract of insurance between the insured and the insurer. Regardless of her community property interest, she is not a party to the contract and can exercise none of the rights of ownership reserved to the insured in the policy. The authorities cited (Br. 7) are not in point here.

Community property passing from the control of the husband, either by reason of his death or by virtue of testmentary disposition by the wife, is subject to his debts and to administration and disposal under the provisions of Division 3 of the Probate Code, "but in the event of such testamentary disposition by the wife, the husband, pending administration, shall retain the same power to sell, manage and deal with the community personal property as he had in her lifetime; and his possession and control of the community property shall not be transferred to the personal representative of the wife except to the extent necessary to carry her will into effect." Probate Code, 52 West's Annotated California Codes, Section 202. In the case of community real property, after 40 days from the prior death of the wife, "the surviving husband shall have full power to sell, lease, mortgage or otherwise deal with the dispose of the community real property, unless a notice is recorded in the county in which the property is situated to the effect that an interest in the property is claimed by another under the wife's will." Probate Code, 52 West's Annotated California Codes, Section 203. Moreover, under Section 300 of the Probate Code, when a person dies, "the title to his property, real and personal, passes to the person to whom it is devised or bequeathed by his will, or, in the absence of such disposition, to the persons who would succeed to his estate as provided in Division 2 of this code, * * *."

In view of these provisions of California law, it would seem to follow that the surviving husband retains all of the incidents of ownership with respect to all of the community property, except that delivered to the personal representative of the wife "to the extent necessary

to carry her will into effect." Probate Code, Section 202. In the present case, this would include the insurance policies here in issue.[2/] It does not follow, however, that the entire proceeds payable under the policies would be includible in the decedent's gross estate for estate tax purposes. It is settled law that upon the prior death of the husband only the value of one-half of the community property is includible in his gross estate as the interest of the decedent in such property

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2/ The statement of petitioners (Br. 6) that "the community property interest of Ruth Scott in said insurance policies was willed by her and distributed from her estate to her sons" (emphasis supplied) is only partially supported by the record. The policies were not mentioned in her will. Her interest in the policies passed to her sons, if at all under the general bequest of "All the rest, residue and remainder of my estate". (R. 95.) The order of distribution was to the same effect. (R. 56-57.) The policies were retained by the decedent, and kept in force by the payment of premiums, until they became payable upon his death. We have not found any California decision holding that beneficiaries under a predeceased wife's will can demand distribution, in the administration of her estate, of the wife's community interest in insurance policies on the life of the surviving husband. In In re Dobbel, 104 Cal. 432, 38 Pac. 87, the husband purchased a paid-up policy on his life, naming his wife beneficiary. She predeceased him by six years, but administration was not taken out on her estate until her husband died, when the proceeds of the policy were paid to her personal representative. The court suggested therein that administration of the wife's estate need not have been delayed so long, but it did not suggest how distribution could be effected unless the policy were surrendered for its cash value. Compare Tyre v. Aetna Life Ins. Co., 54 Cal. 2d 399, 353 P. 2d 725. However, as we understand the California decisions, the beneficiaries under the wife's will would not be precluded from later asserting a claim against his estate if the husband should in the meantime provide for distribution of the insurance proceeds in derogation of their inherited interest.

at the time of his death (Lang v. Commissioner, 304 U.S. 264), and in United States v. Stewart, supra, this Court held that, notwithstanding the incidents of ownership retained after the prior death of the wife by the surviving husband with respect to insurance policies on his life, "at the time of the wife's death she had present, existing and equal rights with her husband in the policies; that these interests amount to ownership of one-half of whatever value the policies had at the time of her death, and that such amount must be included in her gross estate." (270 F. 2d p. 902.) (Emphasis supplied.) In that case, as in the present case, the cash surrender value at the date of the prior death of the wife of policies of insurance on the life of the surviving husband was used as the measure of the wife's community property interest in the policies. The record in the present case affords no other basis for determining the value of the interest which passed under the decedent's will, and the petitioners have suggested none.

In the Stewart case, supra, the District Court held that some 26 insurance policies on the life of the surviving husband at the time of the wife's prior death were community property, but that the wife's rights in the policies at the time of her death were too unsubstantial to permit inclusion of any amount in her gross estate on account of them. Stewart v. United States, 158 F. Supp. 25 (N.D. Calif.). The holding that the policies were community property was not questioned on appeal, and this Court considered the case as presenting the question whether the wife had released her community interest in the policies. (270 F. 2d p. 898.) With respect to 25 of the policies, it was held that the wife had not released her

community interest, and that one-half of the cash surrender value at the date of her death was includible in her gross estate under Section 811(a) of the 1939 Code (corresponding to Section 2033 of the 1954 Code) as the value of property in which the decedent had an interest at the date of her death, and that one-half of the cash surrender value of the other policy was includible in her gross estate under Section 811(c)(1)(B)(1) of the 1939 Code (corresponding to Section 2036 of the 1954 Code) as the value of property of which the decedent had made a transfer under which she retained for her life possession or enjoyment.

The opinions in the Stewart case, supra, do not indicate whether the wife made testamentary disposition of her community property interest in the surviving husband's life policies, as here, or whether her community property interest passed to her husband under Section 201 of the Probate Code, other than the statement of this Court that the trial court's reasoning "overlooks the fact that if the husband took the cash surrender value before the wife's death, it would remain community property in which she had a one-half interest, but if he took the cash surrender value after her death he would be the sole owner. In other words, the right to one-half of the cash value of the policies passed to the husband upon the death of the wife." (270 F. 2d, pp. 898-899.)

In either event, whether the community property interest of the deceased wife in insurance policies on the life of the surviving husband passes to heirs of the wife or beneficiaries named in her will, or passes to the surviving husband under Section 201 of the Probate Code,

the Stewart case, supra, establishes that the community property interest of the wife which passes at her death is one-half of the value of the policies at the date of her death. Where, as here, the predeceased wife's community property interest passed to others than the surviving husband, that value establishes the limit of the interest in the proceeds payable under the policies upon the subsequent death of the husband which can be excluded in computing the value of his gross estate for estate tax purposes. The petitioners have cited no authority to the contrary.

The petitioners correctly state that under California law "those who succeed to the wife's community property interests, by virtue of her Will, must succeed to whatever interest she had at the time of her death; nothing less and nothing more." (Br. 11.) Based on unsound propositions of law and authorities not in point however, it is contended, in effect, that by her will the decedent's wife made a testamentary disposition of one-half of the proceeds payable under the policies on the life of the husband upon his subsequent death. We agree with petitioners (Br. 7) that the question whether the interest of the wife in her husband's life insurance policies is includible in her gross estate for estate tax purposes is determined by state law. For the same reason, the amount includible in the husband's estate, or excludable therefrom, whether he predeceases the wife or survives her, is determined by state law. If the husband predeceases the wife, the wife's community interest at date of the decedent's death is excluded from his gross estate. Lang v. Commissioner, 304 U.S. 264. If the wife predeceases the husband, and her community

property interest is devised or bequeathed to others, [3/] that event establishes the community interest to be excluded from his estate upon his subsequent death.

That the wife may not devise or bequeath more than her interest in property at the date of her death is inherent in general law and is particularly emphasized under California law. As pointed out above, under Section 300 of the Probate Code the title to a decedent's property, both real and personal, and this includes the decedent's interest in community property, passes at the date of death "to the person to whom it is devised or bequeathed by his last will, or, in the absence of such disposition, to the persons who succeed to his estate" as otherwise provided by law. See Fountain v. Bank of America, 109 Cal. App. 2d 90, 240 P. 2d 414. There are many decisions by the California courts dealing with the community property interest of the predeceased wife which passes at her death. E.g., see Makeig v. United Security Bk. & T. Co., 112 Cal. App. 138, 296 Pac. 673; Adone v. Marzocchi, 34 Cal. 2d 431, 211 P. 2d 297, 212 P. 2d 233; Gettman v. City of L.A. Dept. of P. & W., 87 Cal. App. 2d 862, 197 P. 2d 817; Wilson v. Superior Court, 101 Cal. App. 2d 592, 225 P. 2d 1002; Estate of Adams, 132 Cal. App. 2d 190, 282 P. 2d 190. We find no case, however, which remotely supports the petitioners' contention that in this case the beneficiaries become entitled under the

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3/ While the wife may, as stated by petitioners (Br. 9), upon her prior death devise or bequeath her share of the community property, the statement that "During her life the wife may sell or assign her community property interests to whomever she may choose" (Br. 9) is contrary to California community property law.

will of the predeceased wife to one-half of the proceeds of insurance policies on the surviving husband's life which became payable upon his subsequent death.

Completely at odds with the facts and the law in this connection is the statement of the petitioners (Br. 11) that "If her legatees succeeded to an interest in only one-half the cash surrender value of these policies as the Tax Court holds, something material vanished in the process. The California wife has, without due proceeds, been deprived of her property and the right of testamentary disposition of her entire estate." She made testamentary disposition of her entire estate, but her estate at the date of death did not include one-half the proceeds subsequently payable on insurance policies on the life of her surviving husband. Nor did anything vanish. Instead, the policies were kept in effect until the husband's death, and his death added the difference, but not to her estate. The difference between the cash surrender value at her death and the proceeds payable at his death can be attributed only indirectly to the premiums paid. The policies are not in evidence, but it logically can be assumed that the proceeds were payable upon the death of the insured, if still in force, regardless of the length of time premiums were paid.

The petitioners' contention ignores the difference between policy-rights and proceeds-rights, referred to by this Court in United States v. Stewart, supra, p. 900, and fn. 8, and by the Court of Appeals for the Fifth Circuit in Commissioner v. Chase Manhattan Bank, 259 F. 2d 231, 245. At the date of the wife's prior death the community interest of the parties represented only

policy-rights. The proceeds-rights ripened with the death of the insured, when the proceeds became payable to the beneficiaries. The legatees named in the wife's will were named beneficiaries of the policies by the decedent after his wife's death. The difference between the community interest inherited from the mother and the proceeds received under the policies represented the interest passing at the decedent's death, and is property includible in his gross estate.

After citing authorities for certain asserted propositions of law (Br. 7-10) either not germane to the issue involved here or not inconsistent with the Tax Court's holding, the petitioners state (Br. 14) that the Tax Court confused the issue by failing "to recognize that an insurance policy is property, the same as a promissory note, contract or chose in action." The statements that under California law an insurance policy is property which can be "sold, assigned or bequeathed by the owner thereof"; that its extrinsic value "to the owner" is as great as though he held a promissory note of the insurance company, etc., obviously intended to characterize the wife's community property interest in insurance policies on the life of her husband (Br. 7), are inapplicable here because the decedent's wife was not the "owner" of the policies in issue, and the authorities cited (Br. 7) are not determinative of the interest of the wife in such policies subject to her testamentary disposition prior to the husband's death.

This attempted characterization of an insurance policy by the petitioners appears to have been made for the first time by the California courts, and much more appropriately under the facts,

in In re Dobbel, 104 Cal. 432, 38 Pac. 87, cited by petitioners (Br. 7), which involved a paid-up policy on his life procured by the husband in favor of his wife, which the court held was her separate property. Blethen v. Pacific Mut. Life Ins. Co., 198 Cal. 91, 243 Pac. 431, cited by petitioners (Br. 7), was a suit to recover a part of the proceeds of an insurance policy on the ground that it was community property. The only question involved was whether a surviving wife may maintain an action against an insurance company to recover her community interest in the proceeds of a life insurance policy issued to her husband and made payable to a beneficiary other than the wife, without the wifes' consent, after the insurance company, in good faith, without notice of adverse claim thereto, had made full payment on the policy to the beneficiary designated in the policy. She was denied recovery under the facts of that case.

A similar characterization of an insurance policy is contained in In re Mendenhall's Estate, 182 Cal. App. 2d 441, 444, 6 Cal. Rptr. 45, incorrectly cited by the petitioners (Br. 12) as "almost identical" on its facts with the present case, in which the insurance policies on the life of the husband had been converted to paid-up policies, payable to the estate of the husband, before the prior death of the wife. The decision of the Superior Court of San Diego County, California, reversed in Mendenhall's Estate, supra, was given careful consideration by this Court in connection with the petition for rehearing in United States v. Stewart, supra, pp. 903-904.

In re Mendenhall's Estate, supra, involved the question whether the deceased wife's one-half community property interest in the paid-up insurance policies on the life of the husband, in which the

husband's estate was named beneficiary, should be inventoried in her estate for purposes of the state inheritance tax.[4/] In reversing the decision of the Superior Court, the California District Court of Appeal accepted this Court's analysis of California law in the Stewart case, supra (182 Cal. App. 2d, pp. 446-447, 6 Cal. Rptr., pp. 48-49).

That court held, as emphasized in the petitioners' quotation (Br. 14), that since the wife's will devised her estate to other than her husband, "her one-half interest in the policies should have been inventoried as part of her estate for general inheritance tax purposes" (182 Cal. App. 2d, p. 447, 6 Cal. Rptr., pp. 48-49. It did not indicate, however, what that one-half interest represented. In any event, the decision supports the Tax Court's decision in the instant case, rather than the petitioners' contention that one-half of the proceeds of the policies here in issue passed by the wife's will.

Finally, the cases cited for the proposition that "the proceeds of an insurance policy, the premiums on which have been paid out of community assets, are community property" (Br. 8) do not support the petitioners' contention here. In each of the cases cited, the wife survived the husband, which is not the case here, and each case involved the claim of the surviving wife to her community property interest in the proceeds payable under policies of insurance on the life of the deceased husband. They contain no suggestion that a wife who predeceases her husband, as here, can bequeath to others one-half of the proceeds

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4/ In this respect, the issue in Estate of Mendenhall, supra, differed from the issue in United States v. Stewart, supra, which involved the federal estate tax. See Commissioner v. Clise, 122 F. 2d 998, 1001-1002 (C.A. 9th), certiorari denied, 315 U.S. 821, and cases cited; also discussion in United States v. Stewart, supra, p. 899.

subsequently payable under policies of insurance on the life of the husband, rather than her one-half community property interest in such policies at the date of her death.

In United States v. Stewart, supra, this Court said (p. 898):

> While life insurance, because of its hybrid nature, is necessarily accorded individualistic treatment in the law generally, this fact apparently has not been regarded by the California courts as requiring that it be treated sui generis for the purposes of the community property laws. We find nothing in California law which indicates that life policies as items of community property are treated by the rules other than or different from those pertaining to community property generally. [Citations]

While we find no California case dealing specifically with the community property interest in insurance policies on the life of the surviving husband which is subject to the wife's testamentary disposition, the decisions seem to recognize a real difference between the community property interest of the insured survivor and the community property interest of the non-insured survivor. The community property interest of the non-insured survivor in the proceeds of the policy eo instanti ripens and is payable at the instant of the insured's death (New York L. Ins. Co. v. Bank of Italy, 60 Cal. App. 602, 607, 214 Pac. 61, p. 63, and cases cited); and in the case of the insured survivor, his interest in the proceeds either is decreased to the extent of any testamentary disposition by the non-insured decedent or is enhanced to the extent of the community property interest of the non-insured decedent in the absence of testamentary disposition.

In this case, the interest of the insured survivor or his beneficiaries in the proceeds of insurance on his life was decreased to the extent of the policy-interests passing under his deceased wife's will, and there is no authority for holding that the interest

passing to others under the wife's will exceeded her one-half community property interest in the cash surrender value of the policies at the date of her death. Accordingly, we submit the Tax Court did not err in holding that the amount of proceeds payable under the insurance policies in issue, less the wife's one-half interest in their cash surrender value at the date of her death, is property includible in the decedent's gross estate for federal estate tax purposes.

There is even less authority for holding that one-half of the $11,495.05 loan obtained by the decedent on one of the policies shortly prior to his death passed to the beneficiaries under his deceased wife's will, and the Tax Court correctly rejected the petitioners' contention as to this item.

CONCLUSION

The decisions of the Tax Court are correct and should be affirmed.

Respectfully submitted,

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MAY, 1966.

CERTIFICATE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Dated: _____ day of _____, 1966.

APPENDIX

Internal Revenue Code of 1954:

SEC. 2001. RATE OF TAX.

A tax computed in accordance with the following table is hereby imposed on the transfer of the taxable estate, determined as provided in section 2051, of every decedent, citizen or resident of the United States dying after the date of enactment of this title:

* * *

(26 U.S.C. 1958 ed., Sec. 2001.)

SEC. 2031. DEFINITION OF GROSS ESTATE.

(a) General.-- The value of the gross estate of the decedent shall be determined by including to the extent provided for in this part, the value at the time of his death of all property, real or personal, tangible or intangible, wherever situated, except real property situated outside of the United States.

* * *

(26 U.S.C. 1958 ed., Sec. 2031.)

SEC. 2033. PROPERTY IN WHICH THE DECEDENT HAD AN INTEREST.

The value of the gross estate shall include the value of all property (except real property situated outside of the United States) to the extent of the interest therein of the decedent at the time of his death.

(26 U.S.C. 1958 ed., Sec. 2033.)

SEC. 2042. PROCEEDS OF LIFE INSURANCE.

The value of the gross estate shall include the value of all property--

(1) Receivable by the executor.--To the extent of the amount receivable by the executor as insurance under policies on the life of the decedent.

(2) Receivable by other beneficiaries.--To the extent of the amount receivable by all other beneficiaries as insurance under policies on the life of the decedent with respect to which the decedent possessed at his death any of the incidents of ownership, exercisable either alone or in conjunction with any other person. * * *

(26 U.S.C. 1958 ed., Sec. 2042.)

SEC. 2051. DEFINITION OF TAXABLE ESTATE.

For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deduction from the value of the gross estate the exemption and deductions provided for in this part.

(26 U.S.C. 1958 ed., Sec. 2051.)

Treasury Regulations on Estate Tax (1954 Code):

Sec. 20.2042-1 Proceeds of life insurance.

* * *

(c) Receivable by other beneficiaries. (1) Section 2042 requires the inclusion in the gross estate of the proceeds of insurance on the decedent's life not receivable by or for the benefit of the estate if the decedent possessed at the date of his death any of the incidents of ownership in the policy, exercisable either alone or in conjunction with any other person. * * *

(2) For purposes of this paragraph, the term "incidents of ownership" is not limited in its meaning to ownership of the policy in the technical legal sense. Generally speaking, the term has reference to the right of the insured or his estate to the economic benefits of the policy. Thus, it includes the power to change the beneficiary, to surrender or cancel the policy, to assign the policy, to revoke an assignment, to pledge the policy for a loan, or to obtain from the insurer a loan against the surrender value of the policy, etc. Similarly, the term includes a power to change the beneficiary reserved to a corporation of which the decedent is sole stockholder.

* * *

(5) As an additional step in determining whether or not a decedent possessed any incidents of ownership in a policy or any part of a policy, regard must be given to the effect of the State or other applicable law upon the terms of the policy. For example, assume that the decedent purchased a policy of insurance on his life with funds held by him and his surviving wife as community property, designating their son as beneficiary but retaining the right to surrender the policy. Under the local law, the proceeds upon surrender would have inured to the marital community. Assuming that the policy is not surrendered and that the son receives the proceeds on the decedent's death, the wife's transfer of her one-half interest in the policy was not considered absolute before the decedent's death. Upon the wife's prior death, one-half of the value of the policy would have been included in her gross estate. Under these circumstances, the power of surrender possessed by the decedent as agent for his wife with respect to one-half of the policy is not, for purposes of this section, an "incident of ownership", and the decedent is, therefore, deemed to possess an incident of ownership in only one-half of the policy.

(26 C.F.R., Sec. 20.2042-1.)

Nos. 20,391, 20,392 and 20,393

IN THE

United States Court of Appeals

For the Ninth Circuit

DONALD SCOTT, *Petitioner*, vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 20,391
ROBERT SCOTT, *Petitioner*, vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 20,392
ESTATE OF BURT EDSALL, Deceased, MARY E. EDSALL, Executrix, *Petitioner*, vs. COMMISSIONER OF INTERNAL REVENUE, *Respondent.*	No. 20,393

Appeal from the Judgment of the Tax Court of the United States
Honorable Craig S. Atkins, Judge

PETITIONERS' REPLY BRIEF

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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Nos. 20,391, 20,392 and 20,393

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Appeal from the Judgment of the Tax Court of the United States
Honorable Craig S. Atkins, Judge

PETITIONERS' REPLY BRIEF

RESTATEMENT OF PETITIONERS' CONTENTION

It is the contention of Petitioners that only one-half (½) of the proceeds of the insurance policies on the decedent's life are includable within his gross estate for estate tax purposes. The law of the State

of California determines the character, nature and quality of property bequeathed or devised. Under California community property law insurance policies and the proceeds thereof, purchased with community funds, are community property, and as such are subject to the same rules as other community property over which the predeceased wife has an absolute power of testamentary disposition. One-half (½) of the interest in said policies having been disposed of by the predeceased wife, the husband had left to bequeath only a one-half (½) interest therein.

RESPONDENT'S CONTENTION

It is Respondent's position that the predeceased wife's interest in community property insurance policies on the life of her husband is limited to the amount of the cash surrender value of said policies at the time of her death; that the predeceased wife has no power of testamentary disposition over the insurance policies as such; and that under the laws of the State of California and the Regulations of the Internal Revenue Service the entire amount of the proceeds of said policies must be included in the husband's gross estate, less an amount equal to one-half (½) of the cash surrender value of said policies as they existed at the death of the predeceased wife.

ANSWER TO RESPONDENT'S BRIEF

Respondent fails to appreciate the nature of California community property and its application to in-

surance policies. Respondent has neglected to consider the appropriate Internal Revenue Regulations and to properly interpret the California statutory and case law as it applies to the wife's interest in community property insurance policies.

A. INTERNAL REVENUE REGULATIONS

Respondent has taken the position that Dr. Scott retained, after the death of his wife, all of the incidents of ownership with respect to the named insurance policies (BR 11-13); and, therefore, irrespective of California community property law, the entire amount of the proceeds of said insurance policies are includable within the gross estate of the decedent, Dr. Scott. As authority for Respondent's position, Respondent has cited Treasury Regulation on Estate Tax (1954 Code) Section 20.2042-1(c)(2 and 5). Said regulation provides that the proceeds of insurance policies on the life of the decedent shall be includable within the estate of decedent *if* the decedent possessed at his death incidents of ownership over the same.

The Respondent contends that the decedent had the power to assign and revoke assignments of the policies, the right to change the beneficiaries, pledge the policies for a loan, or obtain loans against the surrender value of the policies, and surrender the policies, limited only by the right of legatees under his wife's Will to claim their community interest at the time of her death. It is true that subsequent to Mrs. Scott's death the sons were named beneficiaries under the

policies and that a loan was obtained against their surrender value by Dr. Scott. These factors, however, do not determine or establish that Dr. Scott in fact possessed incidents of ownership over the whole of the policies. What the principals of a contract may believe with respect to their legal rights does not create, establish or determine said legal rights. Furthermore, although the conduct of the parties to a contract may at times demonstrate their intention or belief, they cannot unilaterally deprive another party to the contract of his or her legal rights. The action taken by Dr. Scott with the acquiescence of the insurer, merely indicates a mutual lack of awareness of the nature of the interest which passed to the sons by virtue of Mrs. Scott's Will.

Respondent states that the insurance policy is only a document setting forth the terms and conditions of the contract of insurance between the insured and the insurer and a contract to which the wife is not a party. (BR 13.) To the contrary, however, the California wife is a party in interest to any contract entered into by her husband by virtue of her vested interest in the community property. The mere fact that she is not a named party to the contract is not decisive. She is deemed a party in interest by virtue of her community property rights. The wife's ownership interest in community assets cannot be divested by her husband by his mere refusal to include her as a named party to the contract. It would be a harsh rule and completely contrary to the law of this state to declare that the wife's ownership interest in com-

munity property depends upon whether or not she was named in the contract entered into by her husband. Under such a rule, a husband could adversely affect the wife's property rights through the simple process of transforming community funds into paid up insurance policies, executory contracts or other choses in action. By virtue of the California husband's right to the management and control of the community property, the wife could not set aside during her lifetime such a purchase and under the position contended for by Respondent, at the wife's death she would have nothing more than an interest in the cash surrender or other contingent value of the insurance policy, executory contract or chose in action.

It is inconceivable that Respondent should ask this Court to adopt an unsound principle of law, the effect of which would mean that the California wife has no interest as an owner at death in an asset which was purchased with community funds and which, in the absence of death the wife retained a present, existing and equal interest with that of her husband. Such a rule would defy reason and logic.

Respondent's contention that the interest of the wife in an insurance policy on the life of her husband is not that of an *owner* of the policy (BR 7) is not in accord with California law. *Blethen v. Pacific Mutual Life Insurance Company,* 198 Cal. 91, 98, 243 Pac. 431; *Estate of Dobbel,* 104 Cal. 432, 38 Pac. 87; *Travelers Insurance Company v. Fancher,* 219 Cal. 351, 26 Pac. 2d 482; *New York Life Insurance v. Bank of Italy,* 60 Cal. App. 602, 214 Pac. 61.

By virtue of Mrs. Scott's death, Dr. Scott clearly lost any incidents of ownership which he might have had over her one-half (½) interest in said policies. This position is sound and is recognized and supported by Treasury Regulations on Estate Tax (1954 Code) Section 20.2042-1 (c) (5), the latter portion of which was conspicuously omitted in Respondent's Brief.

The latter portion of the above mentioned subsection provides:

> ". . . For example, assume that the decedent purchased a policy of insurance on his life with funds held by him and his surviving wife as community property, designating their son as beneficiary, but retaining the right to surrender the policy. Under the law the proceeds upon surrender would have inured to the marital community. Assuming that the policy is not surrendered and that the son receives the proceeds on the decedent's death, the wife's transfer of her one-half interest in the policy was not considered absolute before the decedent's death. Upon the wife's prior death, one-half of the value of the policy would have been included in her gross estate. *Under these circumstances, the power of surrender possessed by the decedent as agent for his wife with respect to one-half of the policy, is not for the purposes of this section an 'incident of ownership', and the decedent is, therefore, deemed to possess an incident of ownership in only one-half of the policy.*" (Emphasis added.)

In the present case the insurance policies having been purchased with community funds constituted community property. The decedent husband possessed

incidents of ownership with respect to one-half (½) of the policies only and, consequently, only one-half (½) of the proceeds of said policies are properly includable within his gross estate.

B. CASES RELIED UPON BY RESPONDENT

(1) Respondent relies substantially upon *United States v. Stewart*, 270 Fed. 2d 894, which has been cited throughout its Brief. (BR 4, 10, 16, 22, 23 and 24.) The Court in the *Stewart* case at page 902, stated specifically that

> ". . . we can find no warrant in California law for treating life insurance as a community asset differently from other kinds of property, we hold that at the time of the wife's death she had a present, existing and equal interest with her husband in the policies; . . ."

It is true that the Court went on to state that the interest of the wife amounted to ownership of one-half of whatever the value of the policies were at the time of her death and further that such amount must be included within her gross estate. However, as is fully apparent the Court in the *Stewart* case was concerned only with the *amount* which should be includable in the wife's gross estate and was not confronted with the question of the precise nature and extent of her interest and whether or not the same could be bequeathed by her. To glean from the Court's decision that the wife had only an interest in the cash surren-

der value of the policies is contrary to the Court's recognition that the wife had a present, existing and equal interest with that of her husband in the policies. In light of its actual holding, the *Stewart* case is fully in accord with the California community property law and the California cases concerned with community property insurance policies.

(2) The Respondent has sought to distinguish the cases of *Estate of Dobbel,* 104 Cal. 432, 38 Pac. 87, and *Estate of Mazie O. Mendenhall,* 182 Cal. App. 2d 441, 6 Cal. Rptr. 45, by pointing out that in each case the Court was concerned with a *paid-up* policy. The distinction has no bearing whatsoever on the question of rights. The fact that the policy is paid up merely means that the condition of continued payment of premiums as a prerequisite to enforceability has been removed. Whether the premiums are paid in advance or over a period of time is of no consequence insofar as determining the extent of the wife's community property interest. The only consideration of importance is, not how the premiums are paid, but the character of the funds which are used for this purpose.

(3) Respondent has also attempted without success to distinguish the case of *Blethen v. Pacific Mutual Life Insurance Co.,* 198 Cal. 91, 243 Pac. 431, on the technical ground that the question involved there was whether a surviving wife may maintain an action against an insurance company to recover her community interest in the proceeds of a life insurance policy issued to her husband and made payable to a beneficiary other than the wife, without the wife's

consent. The wife was denied recovery for the reason that no notice of any adverse claim to the proceeds of the insurance policy was given prior to the good faith payment of the proceeds to the beneficiary. The Court stated, however, at page 99, that

> "the *proceeds* of an insurance policy, the premiums on which have been paid out of community assets, are community property." (Emphasis added.)

The clear import of such statement cannot be lightly cast aside.

(4) Respondent argues that since Mrs. Scott predeceased her husband her community property interest in the subject insurance policies could extend to cover only policy rights and not proceeds rights (BR 20-24), and as authority therefor cites language in *New York Life Insurance Co. v. Bank of Italy,* 60 Cal. App. 602, 607, 214 Pac. 61, page 63, to the effect that the interest of the wife *co instante* ripens and is payable at the instant of the husband's death. Respondent has failed again to distinguish between the interest of an owner of an insurance policy prior to the fact of death of the insured and the right to the proceeds when the fact of death has occurred. There is no suggestion in the *Bank of Italy* case that the proceeds of an insurance policy must become due and payable before a community interest can extend to the proceeds themselves. At page 607 the Court pointed out that

> "what we have said disposes of the contention that in order to be classed as community property the proceeds of the insurance must actually have

> become property of the spouses during their joint lives."

Subsequent California cases have examined and reaffirmed this principle. *Estate of Castagnola,* 68 Cal. App. 732, and *Estate of Wedemeyer,* 109 Cal. App. 2d 67, 240 Pac. 2d 8. In the *Castagnola* case the Court stated at page 737

> "the policy of insurance being a chose in action which was community property of the parties during their coverture, the *proceeds* of the policy would retain their community character, notwithstanding the fact that they were paid after the dissolution of the community." (Emphasis added.)

(5) Respondent's overall confusion may be partly attributable to the failure to distinguish the case of *Commissioner v. Chase Manhattan Bank,* 259 Fed. 2d 231. (BR 20.) The community property laws of the State of Texas and of the State of California differ considerably. In Texas the rule is that the insurance policy is community property as to policy rights, but that the transfer or conversion of those rights into proceeds rights by a contract entered into by the husband, in the absence of fraud, cuts off the wife's community property interest. *Commissioner v. Chase Manhattan Bank* (supra). In California, however, the result is entirely different. Under California Civil Code Section 172, any gift of community property without the wife's written consent may be set aside as voidable. During the husband's lifetime, the gift may be set aside entirely; after the husband's death, insurance, for example, is voidable to the extent of

one-half (½) of the policy proceeds. *New York Life Insurance Company v. Bank of Italy,* 60 Cal. App. 602, 214 Pac. 61. This principle is recognized in *United States v. Stewart,* 270 Fed. 2d 894, 900 and is well established. *Travelers Insurance Company v. Fancher,* 219 Cal. 351, 26 Pac. 2d 482; *Blethen v. Pacific Mutual Life Insurance Company,* 198 Cal. 91, 243 Pac. 431; *New York Life Insurance Company v. Bank of Italy,* 60 Cal. App. 602, 214 Pac. 61; *Polk v. Polk,* 228 Cal. App. 2d 763, 39 Cal. Rptr. 824; *Mazman v. Brown,* 12 Cal. App. 2d 272, 55 Pac. 2d 539; *Estate of Parr,* 24 Cal. App. 2d 171, 74 Pac. 2d 792; *Mundt v. Connecticut General Life Insurance Company,* 35 Cal. App. 2d 416, 95 Pac. 2d 966; *Fidelity and Casualty Company v. Mahoney,* 71 Cal. App. 2d 65, 161 Pac. 2d 944.

(6) Respondent takes the further position that California Probate Code Section 202 supports its position of the husband's absolute ownership in the insurance policies of the wife. Such argument is wholly erroneous. The respective interests of the husband and wife in community property during the continuance of the marriage relation are present, existing and equal interests under the management and control of the husband. California Civil Code Sections 172 and 172(a). California Probate Code Section 202 merely insures that the husband's power of management and control over the community property will continue after death pending the administration of her estate, except to the extent necessary to carry her Will into effect. This power of management and con-

trol which the surviving husband retains extends only during the period of administration of the deceased wife's estate. The scope and purpose of Section 202 of the California Probate Code are summarized in *Kanigo v. Grover,* 208 Cal. App. 2d 134, 24 Cal. Rptr. 158, page 146,

> "however, the subject section does not purport to give the husband the right to consume his wife's share of the community property, which was subject to her testamentary disposition, by giving it away or by using it in the payment of debts incurred by him after her death which had no relationship or preservation of their property. The obvious purpose of this statute is to permit the husband to retain possession of the community property except insofar as it is necessary to carry his wife's Will into effect. Consistent with this purpose, he may be required to account to her personal representative for her share."

The Court concludes at page 146,

> "his status in the premises is analogous to that of a trustee authorized to manage and deal with trust property".

See also *Morghee v. Rouse,* 224 Cal. App. 2d 745, 37 Cal. Rptr. 112.

ARGUMENT

Respondent has repeatedly failed to grasp the distinction between the value of an asset and the asset itself. Respondent's Brief incorrectly states that it is Petitioners' contention that by Mrs. Scott's Will she made a testamentary disposition of one-half (½)

of the proceeds payable under the policy on the life of her husband upon his subsequent death. On the contrary, Petitioners contend that Mrs. Scott made a testamentary disposition of her one-half (½) of the community assets—the life insurance policies themselves—and that this interest included all of the rights, powers and privileges incidental thereto. The Petitioners herein, sons of Mrs. Scott, succeeded to exactly the same interest in the insurance policies which their mother had at the time of her death. Any conclusion to the contrary flies in the face of the clear language of California Civil Code Section 161(a) and California Probate Code Section 201.

Respondent throughout its brief has contended that Petitioners ignore the difference between "policy rights and proceed rights". It is without argument that at the time of the demise of Mrs. Scott the decedent was still living and consequently Mrs. Scott had no unconditional right to the insurance proceeds. The conditions precedent to the duty of the insurer to pay said proceeds had not yet occurred. By the same token Dr. Scott would never have the right of enjoyment as a result of the nature of an insurance contract. He, too, had only the right to benefit a third party upon his death, provided the premiums were paid up to that moment in time. There is no distinction between policy rights and proceed rights.

If the right of testamentary disposition depended upon the right of enjoyment of the insurance proceeds, then the same rule by analogy should apply to an insurance policy paid for with the wife's separate property.

Following Respondent's argument if Mrs. Scott had taken out a life insurance policy on the life of her husband and paid the premiums thereon from her separate property, then upon predeceasing her husband, she could bequeath only the cash surrender value of said policy—a rather substantial windfall to the insurance companies. By the same token, under the theory advanced by Respondent, if Mrs. Scott had owned a community interest in an unmatured promissory note at her death, all she could pass on to her sons would be its discount value, since the duty to pay the full amount of principal and interest would not yet have matured. Mrs. Scott's interest in the insurance policies, whether community or separate, was a valuable right which she could pass on to her sons by Will and who by continuing the policies in force would claim the proceeds and realize the enjoyment thereof upon the death of Dr. Scott.

Respondent's argument of policy rights vs. proceed rights is a distinction without a difference under California law.

CONCLUSION

Mrs. Scott at the time of her death possessed, under California community property law, a present, existing and equal interest to that of her husband in the subject insurance policies and her sons received said interest by virtue of her bequest. Her sons received a one-half (½) interest in said insurance policies and not merely a one-half (½) interest in the cash surrender value thereof. To hold otherwise would be

grossly unfair and contrary to the community property laws of the State of California. Petitioners submit that the decision of the Tax Court should be reversed.

WILD, CHRISTENSEN, CARTER & BLANK,
By ROBERT G. CARTER,
Attorneys for Petitioners.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing is in full compliance with those rules.

ROBERT G. CARTER
Attorney

I certify that a copy of the above and foregoing Brief was this date deposited in the United States Mail, postage prepaid, in a cover addressed to Melvin L. Sears, Regional Counsel, U. S. Treasury Department, Internal Revenue Service, Room 628, 447 Sutter Street, San Francisco, California.

Dated, Fresno, California,
June 28, 1966.

ROBERT G. CARTER
Attorney

NO. 20,400

United States Court of Appeals

for the Ninth Circuit

JULIA L. BOSTON, TRUSTEE IN BANKRUPTCY,

Appellant,

v.

LUELLA V. GARDNER, BANKRUPT,

Appellee.

Appeal from the United States District Court
For The District of Oregon

THE HONORABLE WILLIAM G. EAST, *Judge*

BRIEF OF APPELLANT

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Child support payments past due at filing of petition in bankruptcy are in the nature of reimbursement to person having supplied support to child during delinquency of father in making support payments.

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1. Support having been supplied to child by the bankrupt during the father's default in support payments, the father became liable to the bankrupt for reimbursement to the extent of support furnished. Thus, the claim is an asset of bankrupt's estate and passed to the Trustee. 6

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NO. 20,400

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v.

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Appellee.

Appeal from the United States District Court
For The District of Oregon

BRIEF OF APPELLANT

STATEMENT OF THE CASE

About six months before bankruptcy Frederic W. Young, an attorney representing creditors of Mrs. Gardner, subsequently the bankrupt herein, having discovered that the only assets of Mrs. Gardner available to creditors were judgments in divorce decrees of past due child support against two of her former husbands (Severson and Tagliamani) entered into an

agreement with Mrs. Gardner to effect collection of the past due child support upon the judgments, the collection to be applied 50% to Frederic W. Young as his fee for the collection, the moneys then to be applied to the indebtedness owed by Mrs. Gardner to the creditors whom Mr. Young represented and the balance to be remitted to Mrs. Gardner.

The sums accured and owing on these decrees were scheduled by Mrs. Gardner as amounts owing to her at the time of the filing of her petition in bankruptcy on May 6, 1964. (Hereinafter Mrs. Gardner will be referred to as "bankrupt".) As liabilities she listed debts accumulated over many years totaling about $11,600. These debts included many bills owing to doctors, hospitals, groceries, dairies, utilities, landlords and dealers in merchandise of various kinds.

In April, 1964 Mr. Young caused an execution to be issued on the judgment of the Severson divorce decree with a writ of garnishment to be served upon Severson, a resident of the state of Washington, by serving Friden, Inc. in Portland. At the time of the filing of the petition in bankruptcy the child was eighteen and one-half years old. From this writ Mr. Young recovered $149.33, which sum was in his possession at the time of bankruptcy. Upon order of Referee Estes Snedecor, Referee in Bankruptcy, United States District Court for the District of Oregon, Mr. Young, after deducting $4.75 as execution costs,

turned over to the Trustee one-half of the net amount realized. At about the time of bankruptcy Mr. Young obtained an offer from former husband Severson of $800 in full satisfaction of the judgment for delinquent installments. In view of the legal difficulties involved in collection of judgments against one spouse only in a community property state, the Trustee recommended the acceptance of the offer subject to the payment of Mr. Young's contingent fee. The question before the court is whether the Trustee is entitled to the proceeds of the offer and is vested with authority to enter a satisfaction of the judgment.

Referee Estes Snedecor, after a hearing in which the Referee personally questioned the bankrupt, entered herein Referee's Opinion, Findings and Order on the 10th day of December, 1964, in which he decreed that the right to collect the judgment for installments of child support accrued and owing at the time of filing of the petition in bankruptcy passed to the Trustee; subsequently, the bankrupt petitioned the United States District Court for the District of Oregon for a review of the Referee's opinion and the Honorable William G. East, in an opinion dated June 30, 1965 reversed the opinion of Referee Snedecor. Appeal from the decision of Judge East is the matter before this court.

SUMMARY OF ARGUMENT

During the period in which the child's father was delinquent in his child support payments to the bankrupt, the bankrupts creditors, in effect, supplied support for the child. While Courts are reticent to say what portion of common income belongs to the particular member of a family, they are agreed that the benefits and detriments of families are shared by all members of a family.

The schedules of the bankrupt indicate debts to medical doctors, veterinarians, loan companies, several rairies, department stores, several landlords for rent, utility companies, fuel companies, refuse services, transportation expenses, etc.

Clearly, it cannot be denied that these items were shared by the Severson child and each month the father was in default upon his support obligation these creditors and others were deprived of a payment which should have, and no doubt would have, been made to them had the support payments been made by the father to the bankrupt.

It is inconceivable that these creditors may be asked to discharge debts incurred because of the failure to effect collection from the father of this child without sharing in the reimbursement for which the bankrupt contends and which reimbursement is available

to her, and which had formerly been assigned by her for benefit of her creditors.

The present contention of the bankrupt that the past due support payments are not her property is in direct contravention to her position at the time of the making of her contract with and assignment to Frederic W. Young.

Trustee's contention is that the contract is a contract involving property of the bankrupt by way of reimbursement due to the bankrupt from the father for support advanced by the bankrupt for the support of the child during periods of default by the father.

The Bankruptcy Court, as a court of equity, weighed the equities between the bankrupt and the unsecured creditors represented by the Trustee and found the equitable solution to be that the unsecured creditors were entitled to share in the proceeds collectible from child support past due at the filing of the petition in bankruptcy.

Clearly, if a person or agency other than the mother had supplied the support for this child — for instance, an agency such as State Welfare or a grandparent—there is no question but that such agency or other party would be entitled to reimbursement from the father for the support supplied to the child —and there is no question that this indebtedness by

the father to the grandparent would constitute an asset of the grandparent's estate, as a decedent or a bankrupt, and that the cause of action for the reimbursement of funds so spent would survive the grandparent. Certainly, the principle is not *changed* by the fact that the mother of the child supplied support for him during the father's delinquency.

ARGUMENT

I. THE COURT ERRED AS A MATTER OF LAW IN EXCLUDING CHILD SUPPORT PAYMENTS PAST DUE AT DATE OF FILING OF PETITION IN BANKRUPTCY FROM ESTATE OF BANKRUPT.

> *Support having been supplied to child by the bankrupt during the father's default in support payments, the father became liable to the bankrupt for reimbursement to the extent of support furnished. Thus, the claim is an asset of bankrupt's estate and passed to the Trustee.*

Bankrupt's attorney, in his Memorandum of Authority, cites the case of *Pavuk v. Scheetz,* 108 Ind. App. 494, for the proposition that:

> "Decrees of this class do not create the relationship of debtor and creditor between the father and the party to whom the custody of the children is given." p. 501

This sentence must be read in context with the whole opinion and especial attention given to the words of

the sentence. This case says that *Decrees* do not create the relationship of debtor and creditor between the father and the person to whom the custody of the children is given. However, on the preceding page (500 of the opinion) the Court states:

> "This court has held that when the father fails to comply with the court's decree as to payment for support, and continous support is furnished *by the person awarded the custody* so as to meet the exigencies arising, sound public policy requires that the father be held liable to the one having the legal custody of said child, or children, where such person has expended for that purpose an amount equal to, or in excess of that which the father was obligated to pay, but did not pay for the support of the child." *McCormick v. Collard* (1938), 105 Ind. App. 92, 10 N.E. (2d) 742.

Thus it would appear that the rendering of the Decree does not create the relationship of debtor and creditor between the father and the party to whom the custody of the children is given, but that as to past due installments which are in the nature of reimbursements to the person awarded the custody or to the person supplying the support for the child in an amount equal to or in excess of that which the father was obligated to pay, the status of debtor and creditor obtains between the father and the party who has supplied support for the child.

The decision in the *Pavuk* case, supra, turned on the fact that the mother was seeking reimbursement but

had not met the burden of pleading and proving what amounts she had been required to pay and did pay for the maintenance of the child during the time the father was delinquent in the support payments. This case then holds that payments made in accordance with the Decree (which can only mean current and future payments) are to be used for the benefit of the children, but that past due payments are in the nature of reimbursement to the person who has supplied the maintenance of the children.

II. THE COURT ERRED AS A MATTER OF LAW IN RULING THAT CHILD SUPPORT PAYMENTS PAST DUE AT DATE OF FILING OF PETITION IN BANKRUPTCY DID NOT PASS TO TRUSTEE UNDER SECTION 70a(5) OF THE BANKRUPTCY ACT.

Child support is included within the definition of "alimony". As alimony, past due installments pass to the Trustee as a "right of action" under Section 70a (5) *of the Bankruptcy Act.*

In addition to the inclusion of child support within the meaning of alimony in most, if not all, of the cases cited by bankrupt's memorandum, the Oregon court has by a number of decisions definitely stated that child support is included within the definition of the word alimony.

The Oregon case of *State ex rel Casey v. Casey,* 175 Or. 328, 153 P. 2d 700, states:

> "In a strict legal sense, 'alimony' means an allowance which the husband is required to pay to the wife for her maintenance pending or following her divorce or legal separation from him. In a broader sense, however, it covers an award made for the support of minor children. (citing authorities). The legislatures of some of the states have used the word 'alimony' in the sense of support for minor children. (citing authorities)." p. 335.

Alimony due and owing to a bankrupt at the time of filing of the petition in bankruptcy, although not specifically mentioned in the Bankruptcy Act, has always passed to the Trustee in Bankruptcy.

Section 70 of the Bankruptcy Act (11 U.S.C. Section 110) provides that the trustee of the estate of a bankrupt is vested by operation of law with the title of the bankrupt to "property, including rights of action, which prior to the filing of the petition he could by any means have transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded or sequestered: Provided, that rights of action ex delicto for libel, slander, injuries to the person of the bankrupt or of a relative, whether or not resulting in death, seduction, and criminal conversation shall not vest in the trustee unless by the law of the state such rights of action are subject to attachment, execution, garnishment, sequestration or other judicial process."

The exceptions above mentioned do not include rights of action for accrued support of minor children.

> "The specification by the legislature of exceptions to the operation of a general statute, does not necessarily operate to preclude the court from applying other exceptions. However, where express exceptions are made, the legal presumption is that the legislature did not intend to save other cases from the operation of the statute. In such case, the inference is a strong one that no other exceptions were intended, and the rule generally applied is that an exception in a statute amounts to an affirmation of the application of its provisions to all other cases not excepted, and excludes all other exceptions or the enlargement of exceptions made. Under this principle, where a general rule has been established by a statute with exceptions, the courts will not curtail the former, nor add to the latter, by implication. In this respect, it has been declared that the courts will not enter the legislative field and add to exceptions prescribed by statute." 50 Am.Jur., Statutes, § 434.

Futhermore, subsection c of Section 70 of the Bankruptcy Act provides that:

> "The trustee, as to all property, whether or not coming into possession of control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists."

III. THE COURT ERRED AS A MATTER OF LAW IN RULING THAT CUSTODIAL PARENT LACKS OWNERSHIP OF CHILD SUPPORT PAYMENTS PAST DUE AT FILING OF PETITION IN BANKRUPTCY.

The fact that the bankrupt herein chose to levy upon the judgment rather than to bring a contempt proceeding or to sue on the debt to her was a matter of convenience and did not change the character of the debt due from the father to her.

It was bankrupt's testimony at the hearing before Referee Snedecor that she had supplied the Severson child with all the necessaries and any spending money which he required and that this child had wanted for nothing and that, if the father had complied with the terms of the Decree, the money received by her would undoubtedly have been applied to the reduction of indebtedness to creditors listed in her schedules in bankruptcy.

> "Where the father is liable for support furnished by the mother after divorce, the liability is usually enforced in an action at law for necessaries furnished a minor. It has been held that a mother who has furnished such support has her choice of a common law action or a petition to open the the judgment of divorce." 17 Am. Jur., Divorce and Separation, 871 p. 61.

The fact that the bankrupt herein chose to levy upon the judgement rather than to bring a contempt

proceeding or to sue on the debt to her was a matter of convenience and did not change the character of the debt due from the father to her.

In the case of *Pavuk v. Scheetz,* supra, it is stated:

> "If, when need requires, the one granted the legal custody of the child meets any exigency out of his own funds, such action being necessary because of a failure on the part of the father to discharge the duty imposed upon him by the court, then such person, to the extent he has supplied the necessary funds, may recover of the father the amount used for the purpose, provided such amount does not exceed the amount of support money due and unpaid. *McCormick v. Collard.*"

IV. THE COURT ERRED AS A MATTER OF LAW IN RULING THAT THE CHILD SUPPORT PAYMENTS PAST DUE AT THE FILING OF THE PETITION IN BANKRUPTCY COULD NOT SURVIVE THE BANKRUPT, BE TRANSFERRED BY HER, NOR BE LEVIED UPON, SEIZED, IMPOUNDED OR SEQUESTERED IN A PROCEEDING AGAINST HER IN HER PERSONAL CAPACITY.

Clearly, these child support payments past due at the time of the filing of the bankrupt's petition in bankruptcy could be AND IN FACT WERE transferred by her to those of her creditors who were represented by Frederic W. Young.

Equally clear is the fact that this money now owing to the bankrupt in the nature of a reimbursement of moneys already expended by her for the support of the child, while the father was in default in his payments, would survive her, could be levied upon, seized, impounded or sequestered in a proceeding against her in her personal capacity.

> "If, when needs requires, the one granted the legal custody of the child meets any exigency out of his own funds, such action being necessary because of a failure on the part of the father to discharge the duty imposed upon him by the court, then such person, to the extent he has supplied the necessary funds, may recover of the father the amount used for the purpose, provided such amount does not exceed the amount of support money due and unpaid. *McCormick v. Collard.*" *Pavuk v. Scheetz,* supra.

But for the interruption of this assignment by bankruptcy, this assignment would have been carried out by Frederic W. Young and honored by the bankrupt—which would have resulted in payment in full of at least those creditors represented by Frederic W. Young and in whose favor the assignment was drawn.

CONCLUSION

The merits of the Trustee's position are clear and only one result can equitably emerge: the unsecured creditors of the bankrupt should not be precluded from sharing in reimbursement recoverable by bankrupt for support advanced to child during delinquency in support payments ordered to be made by father of child when supplying of support to child by mother deprived creditors of payments in amounts which father was delinquent and for which payments bankrupt failed to effect collection.

Injustice has been done to creditors of bankrupt by precluding them from sharing in reimbursement available to bankrupt. The decision of Judge East should be reversed and the Opinion of Referee Snedecor affirmed.

Respectfully submitted,

JULIA L. BOSTON
Attorney for Appellant.

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JULIA L. BOSTON
Attorney for Appellant.

No. 20,400

United States
COURT OF APPEALS
for the Ninth Circuit

JULIA L. BOSTON, TRUSTEE IN BANKRUPTCY,
Appellant,

v.

LUELLA V. GARDNER, BANKRUPT,
Appellee.

BRIEF OF APPELLEE

Appeal from the United States District Court
for the District of Oregon

HONORABLE WILLIAM G. EAST, Judge

ROBERT L. OLSON,
3443 S. E. 39th Avenue, Portland 2, Oregon,
Attorney for Appellee, Luella V. Gardner.

STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 1-66

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BRIEF OF APPELLEE

Appeal from the United States District Court
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HONORABLE WILLIAM G. EAST, Judge

ADDITIONAL STATEMENT OF CASE

While schedules of bankrupt are extensive, this represented the obligations of three marriages, one of which was to Philip O. Severson, father of Philip A. Severson. Testimony was adduced to indicate that a very few of the present incumbrances besetting the bankrupt were upon behalf of this child, and there was a further indication by appropriate proof that the son was

presently living temporarily with the father, although the mother still maintains actual legal custody.

SUMMARY OF ARGUMENT

Trustee has very capably presented four issues which are facades of but one issue; did the mother bankrupt own the two decrees in her own right.

The answer is diametrically no, because Oregon and other law indicates that the custodial parent operates in a fiduciary relationship or trustee category, and the support payments always should be applied for the benefit of the child.

To hold these payments for the bankruptcy court would violate the purpose for which the payments were ordered, punish the minor for the financial pyramid of not only both of its parents, but also of subsequent wives and husbands respectively who visited this potential farce of punishing a child for the problems of the parents.

Legally, the custodial parent cannot contract away the assets of the minor; and trustee has consistently sought to enforce by legal panacea to give life to a contract void as against public policy.

Further, the bankruptcy trustee takes no title to property which does not belong to the bankrupt and if any such property should come into the trustee's hands, it should be turned over to the rightful owner.

A trustee in bankruptcy takes property subject to

all valid claims, liens and equities and is not an innocent purchaser.

ARGUMENT

I

The custodial parent does not have ownership of support payment because monies due under the decree can be used only for the benefit of the children.

In case cited by Trustee, *Pavuk* v. *Sheetz,* 108 Ind. App. 494 at page 6 of her brief, the next sentence following trustee's quote is at page 501.

> "Such money as is paid by reason of the decree can only be used for the benefit of the children." See Stonehill v. Stonehill (1896), 146 Ind. 445, 45 N.E. 600; Hutchison v. Wood (1915), 59 Ind. App. 537, 540, 109 N.E. 794.

Thereafter, the trustee quoted, on page 7 of her brief, from the same case, *Pavuk, supra.* The next sentence thereafter holds at page 500.

> "This case, however, does not purport to hold that the unpaid installments of support money constitute a debt due from the father to the child's custodian and recoverable by such custodian regardless of what the facts may be in connection with the support and maintenance of the child." p. 500.
>
> "Appellee, although awarded the custody of the children has no proprietory interest in the amounts ordered for their support." at page 501.
>
> "Where an award is made in favor of a wife for permanent alimony in a final decree, to be paid to her for the support and maintenance of their mi-

nor child who is in the wife's custody, upon the receipt of each payment she should use the same solely for the benefit of the child. In the receipt and use of such money, she acts as a trustee or guardian of the minor child. Such judgments are enforceable in the name of the mother for the benefit of the child." Code 30-208, Jackson v. Jackson, 204 Ga. 259 (49 S.E. 662); *Thomas* v. *Holt,* 209 Ga. 133, 134, 70 S.E.2d 595.

"5. When alimony is awarded for the support of minor children, the mother acquires no interest in the funds, and when they are paid to her and she is a mere trustee charged with the duty of seeing that they are applied solely for the benefit of the alimony and ordinarily her conduct can not relieve the father of paying the same as directed by the court." Brown v. Brown, 210 Ga. 233 (78 S.E. 2d 516); Varble v. Hughes, — Ga. 29 (52 S.E.2d 303); Glase v. Strength, 186 Ga. 613 (— S.E. 721); Stewart v. Stewart, 217 Ga. 509, 123 S.E.2d 509.

"3. Appellee, although awarded the custody of the children, has no proprietary rights in the amounts ordered paid for their support. Decrees of this class do not create the relationship of debtor and creditor between the father and the party to whom the custody of the children is given. Such money as is paid by reason of the decree can only be used for the benefit of the children." See Stonehill v. Stonehill (1896), 146 Ind. 445, 45 N.E. 600; Hutchinson v. Wood (1915), 59 Ind. App. 537, 540, 109 N.E. 794. Pavuk v. Scheetz, 108 Ind. App. 494, 501.

"A wife awarded the custody of children, has no proprietary rights in the amounts ordered to be

paid for their support, and the money paid in the decree can be used only for the benefit of the children." 27 (B)—CJS, Divorce, 321 (2).

As provided in ORS 107.420 the custodian is actually accountable to the court for the disbursement of monies received under a decree:

ORS 107.420

"Accounting by custodian of children for support of such children. Whenever a court, in a proceeding for divorce, annulment or separation from bed and board, either before or after decree, awards to a party having the care and custody of minor children money for the support of such children, the court may in its discretion require an accounting from the custodian of the children with reference to the use of the money."

In conclusion, it positively must appear that the custodial parent had no effective personal right in the decree or monies paid thereunder, such as to be transferrable or accruable in such a manner or to be available for trustee's use against defrayment of all of bankrupt mother's bills.

ARGUMENT

II

Bankruptcy trustee takes no title to the property which does not belong to the bankrupt; and trust property should be turned over to its rightful owner.

Child support and alimony are not synonymous terms and even if in certain states the former is in-

cluded within the latter, still the custodian acquires no proprietary interest therein.

> "5. When alimony is awarded for the support of minor children, the mother acquires no interest in the funds, and when they are paid to her and she is a mere trustee charged with the duty of seeing that they are applied solely for the benefit of the children. She can not consent to a reduction or remission of the alimony and ordinarily her conduct can not relieve the father of paying the same as directed by the court." Brown v. Brown, 210 Ga. 233 (78 S.E. 2d 516); Varble v. Hughes, — Ga. 29 (52 S.E.2d 303); Glaze v. Strength, 186 Ga. 613 (— S.E. 721); Stewart v. Stewart, 217 Ga. 509, supra.

As stated by Judge East in his opinion:

> "An examination of the other cases indicates clearly that 'alimony' is not a word of art but that its meaning varies in changing contents, usually statutory. Bennett v. Bennet, 208 Or. 524, 302 P.2d 1019 (1956); Nelson v. Nelson, 181 Or. 494, 182 P.2d 416 (1947); Cogswell v. Cogswell, 178 Or. 417, 167 P.2d 324 (1946)."

Certainly there can be no contention that the support monies would be subject to garnishment for custodian's debt. Which is certainly the position that trustee occupies when they seek to apply past due and delinquent support obligation in payment of all of custodian's bills by allowing the trustee to assume jurisdiction over said funds for the benefit of the general creditors.

The custodian's right of action as involved here does not fit with 70 (5) * * * property, including rights of action, which prior to the filing of petition, he (bankrupt) could have by any means transferred or which might have been levied upon and sold under judicial process against him, or otherwise seized, impounded, or sequestered:

> "Iowa 1941. A bankruptcy trustee takes no title to property which did not belong to the bankrupt although he may have been in possession thereof." Simmermaker v. Intl. Harvesting Co., 298 N.W. 911, 230 Iowa 519. 8 C.J.S. Bankruptcy R. 621, Para. 169.
>
> "Kansas 1939. A trustee in bankruptcy is not an 'innocent purchaser' but takes bankrupt's property subject to all valid claims, liens and equities." *Wyatt* v. *Duncan,* 87 P.2d 233, 149 Kan. 244.

See also Colliers on Bankruptcy 7017 to the effect that where property held by the bankrupt is in the legal name of the bankrupt but held in trust for someone else, the assets should be turned over to the beneficiaries.

CONCLUSION: In this line of cases it is the petitioner's conclusion that the mother takes nothing of beneficial interest, taking the same only for the use and benefit of the ward, and not thereby creating a debtor, creditor relationship such as would cause the rest to pass to the trustee in bankruptcy as an asset of the bankruptcy estate.

ARGUMENT

III

The custodial parent acquires no proprietary interest in child support payments.

In Oregon a parent acquires no property rights in children's property. Att. Gen. Op. Or. 447 and 14 Att. Gen. Op. 287, cannot contract away his rights.

Practically all the other states that have ruled on this matter hold in a like manner. *Stewart and Stewart supra. Thomas* v. *Holt supra.*

> "A wife awarded the custody of children, has no proprietary right in the monies ordered to be paid for their support, and the money paid in the decree can be used only for the benefit of the children." 27 (B), CJS. Divorce 321 (2).

And again in answer to the *Pavuk* case a further development of the citation context reveals

> "Appellee, although awarded custody of the children has no proprietory rights in the amounts ordered for their support. Decrees of this class do not create the relationship of debtor and creditor between the father and the party to whom the custody is given. Such money can be used for the benefit of the children." P. 501, *Pavuk supra.*

Clearly as denoted previously, there is not sufficient ownership in the support payments ordered paid to the custodian to justify general transfer thereof in its entirety without more to the trustee in order to extinguish the general obligations of the parent. In substantiation

of the Oregon position, 14 Att. Gen. Op. 287 is quoted verbatim:

"A parent can not set off against a debt from him to a bank, the deposit of his minor child.

"To warrant a set-off the demands must be mutual and subsisting between the same parties, and must be due in the same capacity and the same right.

"A father has no title to the property of his minor child nor custody nor control of it.

July 18, 1929.

"Hon A. A. Schramm,

Superintendent of Banks.

"Dear Sir: In your letter of July 15 relative to the liquidation of the Astoria Savings Bank you ask my opinion as to the right of a parent to set off the deposit of his minor child against a debt by him to the bank, listing several circumstances under which this demand has been made, such as as where the parent has been given authority to draw on the account; where the money has been deposited by the parent for his child; where the child himself has made the deposit, etc.

"It is a principle of law that a father has no title to the property of his minor child nor custody or control of it. If an infant is the owner of property, a guardian must be appointed to manage such property, the father having the right to be preferred in the selection of the guardian. 20 R. C. L. 613.

"To warrant a set-off the demands must be mutual and subsisting between the same parties, and must be due in the same capacity and in the same right. 34 Cyc. 712-714.

" 'A claim against a guardian individually can not be used as a set-off or counterclaim in an action by him as a guardian, nor is a debt due to defendant as a guardian available as a set-off against a demand due by him individually.' 34 Cyc. 722.

"Section 118, chapter 207, General Laws of Oregon, 1925, the banking act, provides as follows:

" 'When any deposit shall be made by or in the name of any minor, the same shall be held for the exclusive right and benefit of such minor and free from the control or lien of all other persons, except creditors, and shall be paid, together with the interest thereon, to the person in whose name the deposit shall have been made, and the receipt or acquittance of such minor shall be valid and sufficient release and discharge to such bank or trust company for such deposit or any part thereof.'

"In this section our Legislature has recognized the general principle of law that the parent does not have title to his minor child's property. Any interest which the parent might have in such property would be as guardian. The parent can not set off against a debt from him to the bank a deposit in the bank other than one which he owns in his individual right, and, therefore, has no right to set off his minor child's deposit against his debt to the bank irrespective of how the deposit was made for the child.

I. H. VAN WINKLE,
Attorney-General,

By Miles H. McKay, Assistant."

ARGUMENT

IV

The Court was correct in ruling that the custodial parent, as either a trustee or a guardian, albeit natural, lacks ownership for bankruptcy purpose of the choses in action involved here. Those choses could neither survive her nor be transferred by her, nor be levied upon, seized, impounded or sequestered in a proceeding against her in her personal capacity.

In Oregon the parent cannot properly with proceeding to obtain appropriate appointment and approval release a child's personal injury claim. *Ohio Casualty Insurance Co.* v. *Mallison,* 223 Or. 406, 354 P.2d 800 (1960). Additionally, this case sets out the parent as a fiduciary such that a conflict of interest might evolve from the parent dealing in a self-serving capacity.

One attorney general's opinions verify the inability of the parent to control the title and custody and control of the minor's property. 14 Att. Gen. Op. 287, 17 Att. Gen. Op. 447, and the latter is quoted here with regards to the pertinent portion:

> "In re legal liability of a city or of a municipal boxing and wrestling commission in case of injury to a contestant.
>
> "The parent of a minor contestant has no authority to waive, release or compromise a claim by or against such minor.
>
> "When it is mandatory upon a city or town to appoint a municipal boxing and wrestling commission.

July 27, 1935.

"To the Advisory Board of the Boxing and Wrestling Commissions, consisting of the Governor, Secretary of State and Attorney-General.

"Gentlemen: By chapter 290, Oregon Laws 1935, amending sections 56-2901, 56-2903, and 56-2908, Oregon Code 1930, relating to the creating of boxing commissions, their appointment and duties, and to the state advisory board, it is provided that the city attorneys of the respective cities and towns shall have the power to present to the state advisory board such questions as may be deemed necessary for the consideration of the board which shall have the sole discretion in passing upon such questions.

"Inquiry has been made by a city attorney of a city of this state on the following questions:

"1. 'What is the legal liability of the Commission or the City in case of injury to a contestant if he has been given the physical examination required by statute before entering the contest?'

"2. 'If the parents of a minor contestant sign a waiver for him, is this sufficient to relieve the Commission or City from liability for injuries to the minor contestant?'

"3. 'If a petition containing the names of fifty taxpayers or citizens is presented to the Mayor and Council, is it compulsory for the Mayor and Council to appoint a Boxing Commission?'

"Where a minor child is injured by the wrongful act or omission of another, the parent has a right of

action for loss of services of the child and other pecuniary damages sustained by him in consequences of such injury.

46 C. J., section 102, page 1294.

"A parent who consents to the employment of his child in dangerous service assumes the risks incident to the service, in so far as the liability to the parent is concerned, whether the character of the risks is known to him or not, and is not entitled to recover if the child is injured in the service, provided, the employer or, in this instance, the city, town, commission, officer or employee, or either, are free from any negligence.

46 C. J. 1298.

"An agreement by a parent to hold an employer or exhibitor harmless from injury to the child due to the employer's or exhibitor's negligence is void as against public policy.

46 C. J. 1298."

As to the ownership of custodial parent and her power to execute a contract in regard to child support the following are quoted:

"Where an award is made in favor of a wife for permanent alimony in a final decree, to be paid to her for the support and maintenance of their minor child who is in the wife's custody, upon the receipt of each payment, she should use the same SOLELY for the benefit of the child. In the receipt and use of such money, she acts as trustee or guardian of the minor child. Such judgments are enforceable in the name of the mother for the benefit of the child. *Jackson* v. *Jackson,* 20 Ga. 259, 49 S.E. 662; *Thomas* v. *Holt,* 209 Ga. 133, 134, 70 S.E.2d 595.

"3. Guardian of the property of wards are trustees, whose powers over the property of their cestuis que trust are defined by law, and among those pro pers is not to include the execution of a contract binding upon the estate of their wards. *Howard* v. *Cassells,* 105 Ga. 142, 31 S.E. 562, 70 Am. St. Rep. 44; *Lee* v. *Leibold,* 102 Colo. 408, 79 P.2d 1049, 116 A.L.R. 1319, *Thomas v. Holt, supra.*

"4. Where, as in the instant case, custody of minor child was given the mother, and the father required to make monthly payments of alimony to her for the support and maintenance of the child, the mother has no power to make A CONTRACT WITH AN ATTORNEY AT LAW WHEREBY SHE AGREES TO PAY HIM ONE HALF OF WHATEVER SUMS HE COLLECTS FROM THE FATHER BY VIRTUE OF THE DECREE. SUCH AN AGREEMENT BEING CONTRARY TO THE POLICY OF THE LAW, is void, and a court of equity will not aid the attorney in attempting to require the mother to account to him for payments she has received from the father since his employment under the alleged contract, or as to any future payments. *Thomas* v. *Holt, supra.*

"5. The contract of employment between plaintiff and defendant being void, the plaintiff has no lien or claim against any part of the money order or check in his hands, which represents a payment by the father as alimony for support and maintenance of the minor child." *Thomas* v. *Holt, supra.*

Trustee is saying that we should breathe some life into a void act and effectuate that which is against public policy. We point out that the obligation of support

is not dischargeable by reason of bankruptcy, and we do see no lucid reason why a child should be made victim of either the misfortunes or delinquencies of its parent. In this instance, there was testimony at the trial by the bankrupt that only a small portion of the creditors involved in her bankruptcy concerned the child involved here, Phillip Severson.

In answer to the repeated citation of *Pavuk* v. *Scheetz, supra,* we again repeat from said case:

> "Appellee, although awarded the custody of the children, has no proprietary rights in the amounts ordered paid for their support. Decrees of this class do not create the relationship of debtor and creditor between the father and the party to whom the custody of the children is given. Such money as is paid by reason of the decree can only be used for the benefit of the children."

The monies involved here apply as a result of garnishment out of the divorce. The case repeatedly cited by counsel for trustee failed because of the failure of such proof. In any event such specification was not available at the time of the hearing nor thereafter, and the cases distinctly hold that support payments are received by the custodial parent as a fiduciary, and would have to be applied for the benefit of the child.

As stated by Judge East, commencing at the bottom of page 4, of his opinion:

> "Two facets of the *Casey* decision were given particular emphasis by the referee. First, he relied heavily upon the court's discussion of 'alimony' as including child support payments. However, the ref-

bankruptcy purposes of the choses in action involved here. Those choses could neither survive her nor be transferred by her, nor be levied upon, seized, impounded or sequestered in a proceeding against her in her personal capacity.

"Accordingly, the decision of the referee must be reversed and the cause remanded for proceedings not inconsistent herewith.

"DATED June 30, 1965."

CONCLUSION

Legally and equitably this matter should be resolved by reserving to the child the delinquent support payments and thus not making him the donor of a judgment entered for his express benefit, to creditors of three marriages.

The obligation of support is not dischargeable in bankruptcy and we cannot but conclude that all support payments should be reserved for their intended beneficiary, particularly in a State wherein the custodial parent occupies a fiduciary capacity and is subject to an actual accounting to the court for the disbursement of these funds.

This would reflect legislative intention that all of the funds received, no matter at what time, be expended beneficially for the child or children involved.

Respectfully, submitted,

ROBERT L. OLSON
Attorney for Appellee

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion, the foregoing brief is in full compliance with those rules.

ROBERT L. OLSON
Attorney for Appellee

NO. 20,400

United States
Court of Appeals
for the Ninth Circuit

JULIA L. BOSTON, TRUSTEE IN BANKRUPTCY,
Appellant,

v.

LUELLA V. GARDNER, BANKRUPT,
Appellee.

Appeal from the United States District Court
For The District of Oregon

THE HONORABLE WILLIAM G. EAST, *Judge*

REPLY BRIEF OF APPELLANT

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Appellant agrees that the custodial parent operates in a fiduciary relationship or a trustee category and, applying the theory of trusts, the custodial parent is entitled to reimbursement for support rendered the dependant child during the delinquency in payments by the father. As a reimbursement, payments past due at the filing of the Petition in Bankruptcy are the property of the mother in the instant case and pass to the Trustee in Bankruptcy.

Answering Argument 10-27

I. Custodial parent *does* have ownership of installments of child support past due at the filing of the petition in bankruptcy, having derived title through the trust theory principle of reimbursement to the extent bankrupt-custodial parent has supplied support to the child whose father is delinquent in his child support payments 10

II. Bankruptcy Trustee Appellant seeks no title to property which does not belong to the bankrupt and agrees that trust property should be turned over to its rightful owner. In the case in point the rightful owner of the past due payments is the Appellee — to whose property the bankruptcy trustee takes title. 21

III. and IV. The custodial parent acquires no proprietary interest in child support payments made *currently* and in accordance with the decree ordering the payments to be made; however, pay-

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ments past due at the date of the filing of Petition in Bankruptcy are in the nature of reimbursement to the mother for her own funds already advanced for the support of the child and, through the principle of reimbursement of the law of trusts the mother, as trustee, is entitled to reimbursement for any funds expended by her said reimbursement limited only by the amount ordered in the decree. 24

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NO. 20,400

United States
Court of Appeals
for the Ninth Circuit

JULIA L. BOSTON, TRUSTEE IN BANKRUPTCY,
Appellant,

v.

LUELLA V. GARDNER, BANKRUPT,
Appellee.

Appeal from the United States District Court
For The District of Oregon

REPLY BRIEF OF APPELLANT

STATEMENT OF CASE

About six months before bankruptcy Frederic W. Young, an attorney representing creditors of Mrs. Gardner, subsequently the bankrupt herein, having discovered that the only assets of Mrs. Gardner available to creditors were judgments in divorce decrees of past due child support against two of her former husbands (Severson and Tagliamani) entered into an agreement with Mrs. Gardner to effect collection of the past due child support upon the judgments, the

collection to be applied 50% to Frederic W. Young as his fee for the collection, the moneys then to be applied to the indebtedness owed by Mrs. Gardner to the creditors whom Mr. Young represented and the balance to be remitted to Mrs. Gardner.

The sums accrued and owing on these decrees were scheduled by Mrs. Gardner as amounts owing to her at the time of the filing of her petition in bankruptcy on May 6, 1964. (Hereinafter Mrs. Gardner will be referred to as "bankrupt".) As liabilities she listed debts accumulated over many years totaling about $11,600. These debts included many bills owing to doctors, hospitals, groceries, dairies, utilities, landlords and dealers in merchandise of various kinds.

In April, 1964 Mr. Young caused an execution to be issued on the judgment of the Severson divorce decree with a writ of garnishment to be served upon Severson, a resident of the state of Washington, by serving Friden, Inc. in Portland. At the time of the filing of the petition in bankruptcy the child was eighteen and one-half years old. From this writ Mr. Young recovered $149.33, which sum was in his possesion at the time of bankruptcy. Upon order of Referee Estes Snedecor, Referee in Bankruptcy, United States District Court for the District of Oregon, Mr.

Young, after deducting $4.75 as execution costs, turned over to the Trustee one-half of the net amount realized. At about the time of bankruptcy Mr. Young obtained an offer from former husband Severson of $800 in full satisfaction of the judgment for delinquent installments. In view of the legal difficulties involved in collection of judgments against one spouse only in a community property state, the Trustee recommended the acceptance of the offer subject to the payment of Mr. Young's contingent fee. The question before the court is whether the Trustee is entitled to the proceeds of the offer and is vested with authority to enter a satisfaction of the judgment.

Referee Estes Snedecor, after a hearing in which the Referee personally questioned the bankrupt, entered herein Referee's Opinion, Findings and Order on the 10th day of December, 1964, in which he decreed that the right to collect the judgment for installments of child support accrued and owing at the time of filing of the petition in bankruptcy passed to the Trustee; subsequently, the bankrupt petitioned the United States District Court for the District of Oregon for a review of the Referee's opinion and the Honorable William G. East, in an opinion dated June 30, 1965 reversed the opinion of Referee Snedecor. Appeal from

the decision of Judge East is the matter before this court.

SUMMARY OF REPLY ARGUMENT

Appellee's counsel ably advances theories which are thoroughly applicable to *current* support payments and with which the Trustee does not argue as long as the application is made to *current* payments. Payments *past due* at the filing of the petition in bankruptcy are a different matter.

Certainly, there are child support decrees executed upon by mothers, years after children are no longer dependent upon said mothers, for child support due while children were dependent upon the mother and no one can contend that this past due child support must, at the time of collection, be used for the benefit of the child. The proceeds of the execution are received by the mother as a reimbursement for her advancements to the child from her funds during father's delinquency in making payments and are used, rightly so, by the mother for any use which she determines.

Argument by counsel for Appellee that Trustee is attempting to punish the child is without merit and refuted by direct testimony of Appellee before Ref-

eree Snedecor in which testimony Appellee stated that the Severson Child had wanted for nothing during the default of his father — that she, the bankrupt, had amply supported him, supplied him with spending money required and, further, that the settlement which was now offered would be used for home improvement by the addition of a room to the present home of bankrupt although the minor under consideration here had not been living with his mother for several months prior to the hearing before Referee Snedecor. This is conclusive testimony that Bankrupt Appellee considered this a reimbursement and this attitude on the part of the Bankrupt is further illustrated by her prior assignment for the benefit of creditors of this settlement of past due child support to creditors represented by Frederic W. Young. It has been contended that this assignment was for a small amount of indebtedness. To brush this aside as being a small item too insignificant to indicate the bankrupt's intention is analogous to a finding by a criminal court that a crime of robbery was not committed because the amount of money involved was small.

It is a mental gymnastic of complete nonsense to contend that past due support payments are to be received in a fiduciary capacity when the mother has every right to reimburse herself for necessaries ren-

dered to the child under the principles of trust theory for which Appellee so strongly contends.

I find no cases in which trustee has been precluded from reimbursement from the trust estate for necessaries advanced to the beneficiary of the trust.

Appellant does not contend a theory void as against public policy — rather, counsel for Appellee contends for unjust enrichment of a beneficiary of a trust under the theory of trusts so consistently propounded by him in his arguments and brief.

Appellant agrees that the trustee in bankruptcy takes no title to property which does not belong to bankrupt — but contends that reimbursement for necessaries provided the child during the default of the father is the property of the bankrupt.

Appellant contends that there are no superior valid claims, liens and equities against a reimbursement to the bankrupt from *past due* installments of child support as is hereinafter discussed in line with the trust theory advanced by counsel for Appellee.

Any citations from *Pavuk vs. Sheets,* 108 Ind. App. 494, are dicta unless they refer to pleading under the pleading statues of Indiana. This case was an attempt

by a mother who had supplied support for her children to effect collection of past due support payments. Her failure to effect collection was not attributable to the facts in that case but, rather, attributable to her failure to plead the amounts expended by her, which pleading was required by Indiana law. Each citation by counsel for Appellee is by way of explanation that the plaintiff *in that case* may not collect past due installments without suitably pleading the amounts spent by her in support of the child; therefore, *Pavuk* citings by counsel for Appellee are inapplicable to the facts before this Court.

Appellant has at no time contended that Bankrupt has ownership of funds ordered to be paid for child support, only to reimbursements due bankrupt.

The issues involved here are clearly outside the element of ownership. Appellee contends vigorously for the proposition that the mother is a trustee and accountable to the Court for disbursement made — then, conveniently, disregards the fact that in any accounting to the Court moneys expended by the mother would be credited to the mother as trustee and charged against the trust estate.

The theory application propounded by Counsel for

Appellee is inconsistent with the theory of trusts upon which he bases his opposition to Appellant's position.

Appellee says, in effect,

"The mother is a Trustee, the fund does not belong to her, she is entitled to no part of the past due installments even though she has supported the child over the period of several years during default of the father — the child has wanted for nothing — the child is now entitled to be the beneficiary of the proceeds of a fund for his support even though the support for which the fund was ordered has been already rendered to him from his mother's funds."

There is no principle in the law of trusts which supports double benefits to a beneficiary at the expense of a trustee. Contrarywise, and fortunately for trustee, there is a principle requiring reimbursement to the trustee of any funds advanced by the trustee for the purposes of the trust when the trustee supplied necessaries to a beneficiary and this principle is supported by the theory that to deprive the trustee of reimbursement for necessaries advanced to the beneficiary would unjustly enrich the beneficiary of the trust.

Counsel for bankrupt consistently contends that the mother receives the child support payment as a Trustee. Granted that this is true and that the theory of trusts applies, the mother, in receiving past due installments of child support, is entitled to reimburse herself therefrom.

To hold these payments to be subject to the administration of the bankruptcy Court would *not* violate the purposes for which the payments were ordered nor would it punish the minor for the debts of the parents. It was the testimony of the parent at the hearing before Referee Snedecor that the child had wanted for nothing and that the child had been well provided for at the sole expense of the bankrupt.

There is no attempt here to contract away the assets of a minor; there is nothing void as against public policy in the principle of the law of trusts which allows the trustee reimbursement for funds advanced to the beneficiary of the trust.

Appellant agrees that Trustee takes no title to property which does not belong to the bankrupt but contends that installments of child support *past due* at the date of the filing of the petition in bankruptcy are the property of the bankrupt by way of reimburse-

ments to her as trustee of the trust created by the Decree. The rightful owner of the past due installments is the mother, having derived her title through the principle of reimbursement under the theory of trusts for which counsel for bankrupt so strongly contends.

ARGUMENT I

Custodial parent *does* have ownership of installments of child support past due at the filing of the petition in bankruptcy, having derived title through the trust theory principle of reimbursement to the extent bankrupt-custodial parent has supplied support to the child whose father is delinquent in his child support payments.

The portion quoted in Appellee's Brief at p. 3 from the *Pavuk* case, *supra,* is a quotation out of context and does not refer to the *Pavuk* case, *supra.* This is set forth in said brief as a holding of the *Pavuk* case, *supra,* but it is in fact a dictum explaining a previous case in Indiana and emphasizing that the *circumstances* must be pleaded under Indiana law. The quote cited on p. 3 of Appellee's Brief from p. 501 of *Pavuk* case is a further emphasis that only reimbursement will be allowed under Indiana law and then only under proper pleading.

17A *Am. Jur.*, Divorce and Separation, § 873, page 63, discusses the Oregon case of *State Ex Rel Casey v. Casey*, 175 Or. 328, 153 P. 2d 700, 172 ALR 862, as follows:

> "A mother may institute a contempt proceeding in her own name when the decree orders that the payments be made to her; it is not necessary to state that she brings the proceedings for the use and the benefit of the children. She also has a sufficient interest to be able to enforce the decree where, although the court orders the payments to be made to the clerk of the court, no trustee having been appointed to receive and expend the money, she is entitled to receive it and spend it. . . ."
>
> "The mother is not required to plead and prove the amount she spends for the support of her children during the period of the father's delinquency, nor is the court concerned with the use which she may make of the money which the husband is ordered to pay by the judgment of contempt. . . ."

In the *Casey* case, *supra,* all the children had reached majority. It would have been impossible for the support payments to be used for the maintenance and support of minor children. This case definitely represents a reminbursement to the mother as in the case of the bankrupt herein.

> "Where the father is liable for support furnished by the mother after divorce, the liability is usually enforced in an action at law for necessaries furnished a minor. It has been held that a moth-

> er who has furnished such support has her choice of a common law action or a petition to open the judgment of divorce." 17A *Am.Jur.*, Divorce and Separation, 871, p. 61.

The fact that the bankrupt herein chose to levy upon the judgment rather than to bring a contempt proceeding or to sue on the debt to her was a matter of convenience and did not change the character of the debt due from the father to her.

Each of the following Oregon cases *Bennett v.* Bennett, 208 Or. 524, 302 P.2d 1019 (1956); *Cogswell v. Cogswell,* 178 Or. 417, 167 P.2d 324 (1946); and *Nelson v. Nelson,* 181 Or. 494, 182 P.2d 416 (1947), supports the definition of the *Casey* case, *supra.*

OTHER CASES cited by Appellee are inapplicable to the case in point as follows:

Jackson v. Jackson, 204 Ga. 259 (49 S.E. 662), concerned a pleading question under Georgia law. The holding of the case was that the husband was entitled to have the affidavit of execution on judgment follow the wording of the judgment. I am unable to find the portion quoted by counsel in the Georgia report of the case.

Thomas v. Holt, 29 Ga. 133, 134 (49 S.E. 662). This

case involved an attorney seeking an accounting for payment of past due as well as current payments received by wife for whom attorney had secured partial payment on the past due. Note: Georgia law requires a suit to be brought by the mother for the benefit of the children. Oregon law does not so require as illustrated in the *Casey* case, *supra*.

Brown v. Brown, 210 Ga. 233, 78 S.E.2d 516. The court said at p. 235;

> "The question presented for decision by the record before us is whether subsequent cohabitation by husband and wife ipso facto annuls and sets aside the previous decree for alimony, or whether it remains of full force and effect and is res judicata as to rights of wife to recover temporary alimony and attorney's fees for herself and minor child in a divorce and alimony proceedings instituted by her following a later separation, until the former decree for permanent alimony has been vacated and set aside in the Court where the prior verdict and decree were rendered."

The court held that the right of the wife to alimony for herself was not res judicata and that voluntary cohabitation rendered void judgment for alimony to her but did not effect the award to the children.

NOTE: This court used the expression *"alimony* for support of minor child". (Emphasis added.)

Varble v. Hughes, 52 S.E.2d 303. This case also discusses "alimony for the benefit of minor children" and states that "the parents themselves cannot by subsequent agreement nullify or modify the final decree so as to deprive the children of the *alimony* granted by the verdict and decree." In the case before the court at this time there is no question that the Severeson child has been denied support. It is agreed that ample support has been furnished by the mother.

Glaze v. Strength, 186 Ga. 613. Holds that parents may not agree among themselves that payments need not be made. The wife had released all claims of alimony (presumably future) for herself and for her child for $400. 00.(Parenthetical material added.)

NOTE: This court also called this payment alimony for the child.

Stewart v. Stewart, 217 Ga. 509. Holds that refusal of mother to allow visitation of father does not nullify duty of father to pay *"alimony for support of children"* unless visitation rights are a condition precedent to the payment of alimony. (Emphasis added.)

NOTE: This court terms child support "alimony for support of children" — page 510 (3).

Stonehill v. Stonehill, 146 Ind. 445, 45 N.E. 600. Involved attachment for contempt of court and stated that imprisonment for contempt for failure to pay money as ordered by the court is not imprisonment for debt within the meaning of the Constitution.

Hutchinson v. Wood, 59 Ind. App. 537, 540. The decree under consideration here stated:

> "Court further finds for the plaintiff in the sum of $400.00 against the defendant as *alimony*, to be used for the support of the children . . ." (Emphasis added.)

The Supreme Court held that the decree ordering a judgment against husband for alimony for the support of children becomes a lien upon real property which was the only question presented for clarification in the *Hutchinson* case, *supra*.

Ohio Cas. Ins. Co. v. Mallison, et ux, 223 Or. 406. This case involved the violation of the fiduciary relationship between the parents and the child and it concerns the parents giving a release to an insurance company for payment to them which apparently was disproportionate to the damages received by the child and the case turned on the principle that the agreement has the tendency to place the parent in a position where his interest will conflict with that of his

child, and that the agreement therefore violates the principle that one who is a fiduciary for another may not undertake an obligation inconsistent with his fiduciary duty. This case is inapplicable under these circumstances because the past due installments of child support, being in the nature of a reimbursement, are the property of the mother and there is no conflict of interest.

17 *Attorney General Opinions,* Oregon 447 involved the release of a tort claim by or against a child, executed by his parents. This opinion has no application to the case before the Court.

14 *Attorney General Opinions,* Oregon 287 holds:

> "A parent cannot offset against a debt from him to a bank the deposit of his minor child."
> and
>
> "A father has no title to the property of his minor child nor custody nor control of it."

This Opinion states that the father cannot contract away his child's rights. In the case before the court the child's rights are not concerned since the child has had the benefit of the mother's resources in an amount equal to or in excess of the payments required to be made by the father. The claim is that of the bankrupt and not of the child.

C. F. Simmermaker v. International Co., 230 Iowa

845. This case concerned two rival claimants to fixtures; neither of the claimants was a bankrupt, his trustee or any creditor.

Wyatt v. Duncan, 149 Kan. 244. Concerns conditional vendor who had repossessed goods prior to bankruptcy. The trustee contended this was a transfer within four months of bankruptcy and instituted action to recover from the surety for failure of the surety to pursue replevin. Clearly, no application here.

The decision of Judge East in the matter before this court appeared to be based upon his conclusion that the bankrupt lacked ownership of the funds payable under the Decree. Both the Judge and the Counsel for the bankrupt appear to accept the theory of trusts and place the mother in the position of a Trustee. With this theory the Trustee in Bankruptcy is in complete agreement and fails to understand why counsel for bankrupt, while definitely and emphatically propounding the theory of trust on which to base the claim of the bankrupt to the funds, resists the principle of trusts which allows reimbursement and exoneration of the trustee (in which position counsel for bankrupt and Judge East placed the bankrupt.)

54 *Am. Jur.,* Trusts, §514 discussing reimbursement and exoneration of the Trustee:

> ". . . as between the Trustee and the Trust Estate the latter ultimately is to bear the cost of all expenses and liabilities properly incurred by the Trustee in the administration of the Trust. If the Trustee advances his own money or uses his own property in discharging such properly incurred obligations, he is entitled to reimbursement out of the trust estate; or if he has not in fact advanced his own money or used his own property to satisfy such obligation he is entitled to exoneration, that is, to use or apply the Trust funds or property in the discharge of the liability. In a proper case a creditor may, upon the theory of the subrogation, be substituted to the Trustee's right of exoneration.
>
> "As between himself and the Trust Estate, a Trustee is entitled to reimbursement or exoneration not only where he enters into a contract which is proper in the administration of the Trust and is binding upon him personally, but also in cases where, without personal fault on his part, he is subjected to tortious liability in the administration of the estate. . . .

". . . the right of a Trustee to reimbursement or exoneration does not depend upon knowledge or consent of the cestuis que trust to the expense incurred, . . ."

54 *Am. Jur.,* Trusts, §516, consideres the lien or charge on the trust estate created by the Trustee's right to reimbursement:

> "A Trustee entitled to reimbursement or exoner-

ation out of the trust estate for liabilities properly incurred in the administration of the trust is generally regarded as having a security interest in or lien on the trust estate, and he may retain control thereof until he receives such reimbursement or exoneration. Such a charge or lien upon the Trust property for reimbursement *does not affect the question of the actual and beneficial ownership of the subject of the trust.* (emphasis added).

"The charge or lien of a trustee for reimbursement for expenditures *is superior to the interest of the beneficiaries of the trust.* (emphasis added) "Where a Trustee has paid off an encumberance on Trust property or purchases it or an outstanding title to it, acting in his sound discretion to protect it, he is entitled to reimbursement, and he may retain the property freed or purchased as security for expenditures that he has made in the transaction out of his own funds."

54 *Am. Jur.*, Trusts, §519, discusses advances to beneficiaries for support:

"The cases vary in their conclusions on the questions of the right of Trustee to reimbursement for advances of his own funds in making payments to beneficiaries at a time when trust funds are not available, . . . These conflicting views extend to cases involving the right of a Trustee to reimbursement for advances from his private fund made to the beneficiary of a support or spendthrift trust. Reimbursement has been limited, at least where payment is made to beneficiary without knowledge on his part of the deficiency of trust funds and that the payment is out of the private funds of the Trustee, to income subsequently received on the identical in-

> vestments which were in default. A Trustee is entitled to reimbursement for support of a beneficiary out of his own means . . . irrespective of the means of the Trustee and of the fact that the Trustee is under duty to support the beneficiary . . ., as is the case where the beneficiary is the child of the Trustee."

Restatement of Trusts, §244:

> "The Trustee is entitled to indemnity out of the trust estate for expenses properly incurred by him in the administration of the trust . . .
> "b. *Indemnity by way of exoneration or reimbursement.*

If the Trustee properly incurs the liability in the administration of a trust, he is entitled to an endemnity out of the trust estate either by way of exoneration, that is by using trust property and discharging the liability so that he will not be compelled to use his individual property in discharging it, or by way of reimbursement, that is, if he has used his individual property in discharging the liability, by repaying himself out of trust property.

"c. *Lien for indemnity.* To the extent to which the trustee is entitled to indemnity, he has a security interest in the trust property. He will not be compelled to transfer the trust property to the beneficiary or to a transferee of the interest of the beneficiary or to a

successor trustee until he is paid or secured for the amount of expenses properly incurred by him in the administration of the trust."

ARGUMENT II

Bankruptcy Trustee Appellant seeks no title to property which does not belong to the bankrupt and agrees that trust property should be turned over to its rightful owner.

In the case in point the rightful owner of the past due payments is the Appellee — to whose property the bankruptcy trustee takes title. Agreeing with Counsel for Appellant that this is trust property — it is subject to a charge by the mother — trustee of the fund, for reimbursement to her for her funds expended for necessaries supplied the beneficiary of the trust and her charge against the fund has priority over any claim of the beneficiary of the trust. A trustee's claim for reimbursement is certainly available to the trustee's creditors. The mother - trustee has a personal right in these funds under the principles of trust law which law counsel for Appellee thoroughly embraces on her behalf but refuses to follow through to the logical conclusion an application of the law of trusts relative to reimbursement of trustee for amounts advanced by her.

Whether or not child support and alimony are synonymous is of little import if we pursue the theory of trusts with which counsel for bankrupt appears to be so enamored. On Page 6 of Appellee's brief, the last paragraph being "certainly there can be no contention that the support monies would be subject to garnishment for custodian's debts." Appellant makes such a contention based upon the following:

Scott's Abridgment of the Law of Trusts §267:

> "Examination of the authorities discloses that there is support for each of the following theories to justify a recovery out of trust estate by third person to whom the trustee has incurred a liability in the administration of trust.
>
> 1. The creditor is entitled to obtain satisfaction of his claim out of trust estate if and through the extent that the trustee is entitled to indemnity out of the trust estate.
>
> 2. The creditor is entitled to obtain satisfaction of his claim out of the trust estate if and to the extent that the trust estate has been benefited by the transaction out of which his claim arose, even though the trustee is not entitled to indemnity out of the trust estate.

Scott's Abridgement of the Law of Trusts § 268:

> ". . . A more accurate statement is that the third person is entitled to maintain a bill in equity against the trustee for equitable execution, a creditor's bill, a bill to reach and apply to

the satisfaction of his claim assets which could not be reached in an ordinary proceeding at law.

"This method of reaching the trust estate through the trustee's right of indemnity has found acceptance in England and in most of the States. Accordingly, it has been held that a person with whom a Trustee makes a contract in the proper administration of a trust, and who cannot obtain satisfaction of his claim in an action at law against the trustee personally, is entitled to maintain a bill in equity against the trustee to reach the trust estate to the extent to which the trustee is entitled to exoneration out of the trust estate. See *Mason v. Pomeroy,* 151 Mass. 164, 24 N.E. 202 (1890)"

Scott's Abridgment of the Law of Trusts §268.1:

"A person to whom a trustee has incurred a liability in the administration of the trust cannot maintain a proceeding in equity to reach the trust estate through the trustee's right of exoneration if he has an adequate remedy against the trustee personally in an action at law. In some cases it has been held that the creditor must first obtain a judgment against Trustee and have the execution return nulla bona before he can bring a bill for equitable execution. In most states, however, he is permitted to maintain a suit in equity without having first obtained a judgment at law, if the trustee has no assets which could be reached by legal execution. *It is sufficient that the trustee is insolvent* . . . (Emphasis added)

Scott's Abridgment of the Law of Trusts, §269:

". . . Where a person, not acting officiously or

> gratuitously has conferred a benefit upon the trust estate, he can by proceeding in equity reach trust property and apply it to the satisfaction of his claim to the extent which the trust estate was benefited. The relief thus given him is based upon the general principle that one person should not be unjustly enriched at the expense of another, that if the trust estate is enriched at the expense of a third person, it would be inequitable to deny to the third person a recovery out of the trust estate. This is true whether the benefit was conferred under a contract made by the trustee with the third person, or as the result of a tort committed by the trustee against the third person or where the third person confers a benefit upon the trust estate under such other circumstances that the estate is unjustly enriched . . ."

ARGUMENTS III AND IV

The custodial parent acquires no proprietary interest in child support payments made *currently* and in accordance with the decree ordering the payments to be made; however, payments past due at the date of the filing of Petitions in Bankruptcy are in the nature of reimbursement to the mother for her own funds already advanced for the support of the child and, through the principle of reimbursement of the law of trusts, the mother, as trustee, is entitled to reimbursement for any funds expended by her, said reimbursement limited only by the amount ordered in the decree.

It has consistently been the policy of the Bankruptcy Court of the United States District Court for the District of Oregon to rule that installments of child support past due at the date of the filing of the petition are assets of the bankrupt's estate.

The *Case of Ohio Casualty Insurance Co. v. Mallison*, 223 Or. 406, 354 P2d 800 (1960) involved the waiver of a tort to a child and have nothing whatever to do with assets in the nature of a reimbursement of a parent of the child. The quotations from 46 *CJ*, appearing on Page 13 of Appellee's Brief refer to waiver of liability for tort and cannot possibly be applicable to the case under consideration either in theory or in fact. Counsel for bankrupt quotes at page 13 from a citation of *Jackson v. Jackson*, 204 Ga. 259, setting forth what has to be dictum in that case because, as reflected on page 12 of this brief, the Jackson case was a holding concerning pleading under the laws of the State of Georgia and the sole finding of the case was that the husband was entitled to have the affidavit of execution on judgment following the wording of the judgment. I have been unable to find, in the Georgia report of this case, the quote shown by counsel in his brief.

On page 14, counsel discusses the case of *Howard v. Cassels* 105 Ga. 412, (rather than 142 as stated in

bankrupts brief). Any quote from this case other than one regarding the pleading question involved there as to the necessary parties to that suit is a quotation of dictum in the case.

On the same page counsel discusses *Thomas v. Holt*, 29 Ga. 133, which is inapplicable to the facts in this case since Mr. Thomas, as an attorney, was seeking an accounting from the mother of current payments received in order to ascertain his fee. The appellant herein makes no claim to current payments and any discussion of current payments is inapplicable to the question before the Court. On page 15 of Appellee's Brief there is another quote from the case of *Pavuk v. Sheets, supra.* This case was first quoted by counsel for bankrupt and appellant has at all times contended that the portion cited by counsel for bankrupt is dictum. Reference to Page 2 of Trustee's Answering Memorandum and Memorandum of Authority as originally presented herein will show that there is opposing dictum in the same case and that the case turned on the fact that the mother had not pleaded in accordance with the pleading laws of the State of Indiana. Any quotation from this case not regarding the pleading question is dictum and of no avail here. A reading of the *Pavuk case, supra,* will reveal that it did not fail *because of proof* as specified in Appellee's

Brief. It failed long before the proof stage *because of failure to meet the code pleading requirements of the State of Indiana* and it does not distinctly hold that support payments are received by custodial parent as a fiduciary, rather, it holds that the mother cannot maintain a case in Indiana without a pleading in accordance with the pleading code of the State of Indiana.

Citations by Counsel for bankrupt from 46 CJ 102, 128 and 1298 pertain to tort liability and this question is not before the Court.

Counsel for bankrupt places special emphasis on the *Thomas v. Holt* case, *supra*, but the holding therein mentions only current and future payments and is silent concerning past due payments.

Appellant suggests that headnotes were cited throughout Appellee's brief without regard to a reading of the facts in the cases cited. A reading of the factual situation of the cases and opinions substantiates Appellant's position rather than Appellee's.

CONCLUSION

Whether or not the obligation of support is dischargeable in bankruptcy is not before the Court at this time and it is well settled that it is not dischargeable in bankruptcy. The appellant is not concerned with the dischargeability of the payments for child support or any payment due on or after the date of the filing of the petition herein. To say now that money paid for months and years past should be directed only to the benefit of the child is a mental gymnastic of fantastic proportions. The child was well supported by his mother during the time that the father was delinquent in his support payments and to rule now that the payments past due at the date of the filing of the petition in bankruptcy are to be used for the benefit of this child would result in unjust enrichment to the beneficiary of a trust for which Appellee contends. The child was supported once, wanted for nothing according to his mother's testimony, and to again allow this payment not to be applied to the creditors who in effect supported this child during that father's delinquency is indeed inequitable. There is no legislative nor legal intention evidenced that all funds received, no matter at what time, should be expended beneficially for the child or children involved; rather, the in-

tent and practice is to reimburse the parent who has supplied support during the delinquent period.

Clearly, the child — having been supported once — is not entitled to have support again for the same period of time while th creditors who supplied family necessaries are forced to discharge the obligations for those necessaries.

The inequities visited upon creditors by the District Court's overruling Referee Snedecor's opinion must, in all good conscience, be alleviated by a judgment of this Court.

Respectfully submitted,

JULIA L. BOSTON

Attorney for Appellant

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JULIA L. BOSTON
Attorney for Appellant.

Brief of Appellant

United States Court of Appeals

for the Ninth Circuit

No. 20402

MONDAKOTA GAS COMPANY, a corporation,

Appellant,

vs.

COLLINS G. REED and
MRS. COLLINS G. REED, et al,

Appellees.

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Brief of Appellant

United States Court of Appeals

for the Ninth Circuit

No. 20402

MONDAKOTA GAS COMPANY, a corporation,

Appellant,

vs.

COLLINS G. REED and
MRS. COLLINS G. REED, et al,

Appellees.

JURISDICTION

Appellants commenced this action in the District Court of the Sixteenth Judicial District of the State of Montana in and for the County of Fallon. The action was removed to the United States District Court on the grounds of diversity of citizenship of the parties. There is diversity of citizenship and the amount in controversy exceeds $10,000.00, and the District Court and this Court have jurisdiction under Title 28, U.S.C.A. §1332.

STATEMENT OF THE CASE

The questions involved in this case are whether or not a material issue of fact remains so that summary judgment should not have been granted to the defendant Collins Reed, and secondly, whether or not a new trial should have been granted upon the motion for new trial which includes the question whether or not the District Court should have ordered further discovery procedure during the pendency of the appeal or during the period of hearing the motion for new trial.

These questions are raised first, by the motion for new trial as to the findings of the trial court and by appeal from the summary judgment herein, with reference to the chain of title of the defendant Collins Reed upon which the trial court predicated the judgment against the plaintiff. The question of the motion for new trial will be argued separately and involved therein the questions as to further discovery and the granting of a new trial based upon the showing in the motions and affidavits and particularly the subsequent judgment of the District Court of the State of Montana in and for the

County of Yellowstone, cause No. 28573, entitled Mondakota Gas Co., —vs.— Industrial Gas Inc.,

With reference to the subsequent judgment of the Yellowstone County District Court of the State of Montana, the contract, by which the defendant Collins Reed obtained his title, or claimed to have obtained his title, is fully set forth and recorded in Book 665 of Judgments and Decrees, page , on May 17, 1965, of Fallon County wherein the property is located.

The chain of title is as follows:

The chain of title will begin within a common owner, the plaintiff herein, who sold to E. L. McElroy under a purchase agreement covering the real property interest involved herein, situate in Fallon County, Montana, to-wit:

W½, Section 18, Township 8 North,
Range 60 East, M.P.M., and
NE¼, Section 25, Township 8 North,
Range 59 East, M.P.M.

COMMON PREDECESSOR

Mondakota Gas Co. Chain

Purchase Agreement from Mondakota Gas Company (Appellant) to E. R. McElroy dated June 17, 1952, recorded in Book 30, pages 4 and 24, records, Fallon County, Montana, (Tr. Vol. 1, pg. 21 and 41 herein), recorded Jan. 12, 1953, at 9:35 a.m., (Tr. Vol. 1, pg. 57, herein; Tr. Vol. 1A, pg. 180).

Collins Reed Chain

Purchase Agreement from Mondakota Gas Company (Appellant) to E. R. McElroy dated June 17, 1952, recorded in Book 30, pages 4 and 24, records, Fallon County, Montana, (Tr. Vol. 1, pg. 21 and 41 herein), recorded Jan. 12, 1953, at 9:35 a.m., (Tr. Vol. 1, pg. 57, herein; Tr. Vol. 1A, pg. 180).

RECORDED INSTRUMENTS IN FALLON COUNTY

Mondakota Gas Co. Chain

Judgment and Decree in case No. 28573, Montana District Court, Yellowstone County, terminating the purchase agreement between Mondakota Gas Co. and Industrial Gas Co. dated June 20, 1953, recorded in Fallon County on May 29, 1954, in Book 34 Misc. Records, pg. 367 (Tr. Vol. 1A, pg. 230, lines 2-7), referring to Purchase Agreement of McElroy set out above (Tr. Vol. 1A, pg. 230, lines 7-19), referring to quit claim deed and assignment of McElroy to Industrial Gas Co. on July 20, 1953, (Tr. Vol. 1A, pg. 230, lines 11-19) and referring to assignment subject to the Purchase Agreement in Book 30, Misc., pg. 4, above, by Mondakota to McElroy (Tr. Vol. 1A, pg. 230, lines 15-19), the Judgment and Decree showing chain of title to the interests claimed by Reed herein (Tr. Vol. 1A, pg. 231, lines 26 to 32, inclusive, and describes said real property and Federal Lease Serial No. 025001 (Walker Lease) (Tr. Vol. 1A, pg.

Collins Reed Chain

None. (Tr. Vol. 1A, pg. 161, lines 21 through 30; Tr. Vol. 1A, pg. 133, lines 11 through 23).

233, lines 3-33 inclusive) and recorded in Book 665 of Judgments and Decrees, pg. ____, on May 17, 1965, in Fallon County, Montana (Tr. Vol. 1A, pg. 225, lines 14-22; and Tr. Vol. 1A, pg. 235).

UNRECORDED INSTRUMENTS

Mondakota Gas Co. Chain

McElroy to Industrial Gas, assignment and deed referred to above; Decree recorded in Book 665 of Judgments and Decrees, pg. ___, on May 17, 1965, in Fallon County, Montana.

Collins Reed Chain

McElroy to Buchtel dated May 28, 1953 (Tr. Vol. 1A, pg. 161, line 25).

Buchtel to Collins Reed dated October 24, 1954 (Tr. Vol. 1A, pg. 161, line 28). These instruments still show, from this transcript herein, to have never been recorded in Fallon County, Montana.

The motion for new trial filed by Mr. Kelleher included affidavits (Tr. Vol. 1A, pg. 167 and 172) wherein it is shown that after trial appellant learned that appellee Collins Reed was a brother-in-law of one Edward Markey, who was a business partner of McElroy (Tr. Vol. 1A, pg. 173) and that McElroy was a brother-in-law of Buchtel (Tr. Vol. 1A, pg. 173).

The affidavits of Smith and Hutchison (Tr. Vol. 1A, pages 216-219) show the act of McElroy in obtaining the assignment which was unrecorded but upon which Reed predicates title through Buchtel. (See Motion re: New Trial, Tr. Vol. 1A, pg. 211.)

SPECIFICATION OF ERRORS

The Appellant relies upon the following specifications of errors which will be urged herein:

1. The court erred in applying res judicata from Case No. 27622, Yellowstone County, Montana, and Case No. 1557 in U. S. District Court and applying Rule 41(b) of the Montana Rules of Procedure.

2. The court erred in failing to find that the defendant, Collins G. Reed, had constructive notice by reason of the recording of the purchase agreement by the Appellant and McElroy in the office of the Fallon County Clerk and Recorder.

3. The court erred in failing to find that the purchase agreement mentioned in 2. above was recorded prior in time to the assignment upon which the defendant Collins G. Reed bases his chain of title.

4. The court erred in failing to find that the assignments numbered 10, 11 and 12 in the judgment were not recorded at all in the office of the County Clerk and Recorder, Fallon County, Montana.

5. The court erred in refusing to grant a new trial based upon newly discovered evidence that McElroy and Markey were business partners, that Buchtel is a brother-in-law of McElroy, and Collins G. Reed, appellee herein, is the brother-in-law of Markey, and all parties named herein had both actual and constructive notice of the purchase agreement reserving title in the appellant including a royalty interest claimed herein by Collins G. Reed and his wife and were not bona fide purchasers of said royalty interests.

6. The court erred in failing to grant the appellant discovery procedure by way of depositions, interroga-

tories and discovery instruments to be used in support of the motion for new trial.

7. The court erred in denying the motion for a new trial as amended.

8. The court erred in denying the motion to amend the motion for new trial dated June 9, 1965, which incorporated a subsequent decree of the Yellowstone County District Court, State of Montana, cause No. 28573, which judgment and decree was recorded in Fallon County, Montana, prior to recording of the assignments upon which Reed bases his chain of title.

9. The court erred in finding that Collins G. Reed, Fidelity Gas Company, Montana-Dakota Utilities Company, and Shell Oil Company included the royalty interest set forth in paragraphs 10, 11 and 12 of the judgment dated August 31 ,1964, and finding that plaintiff's only interest is the overriding royalties.

10. The court erred in denying the relief prayed for and abused his discretion in failing to grant a new trial in the furtherance of justice (Tr. Vol. 1A, pages 241-243, Statement of Points).

ARGUMENT

In Montana, a quiet title action is proper procedure to litigate rights to oil and gas leases and royalties. See Schumacher v. Cole, 131 Mont. 166, 309 P. 311. A Lis Pendens is filed in the county clerk and recorder's office in the case and constitutes notice to persons seeking to subsequently record an instrument affecting title to the interest involved in litigation. Sec. 93-3005 and 93-6205 R.C.M. 1947.

Montana Rule of Evidence is that a certified copy of a recorded instrument is admissible in evidence the same as the original. See Sec. 93-1101-21, R.C.M. 1947. The trial court had the photo copy before it, and there was a material issue of fact precluding summary judgment against plaintiff, as to Collins Reed (Tr. Vol. 1, pg. 21, 41 and 57).

> "It may well be that the weight of the evidence would be found on a trial to be with defendant. But it may not withdraw these witnesses from cross-examination, the best method yet devised for testing trustworthiness of testimony. And their credibility and the weight to be given to their opinions is to be determined, after trial, in the regular manner." Sartor v. Arkansas Natural Gas Corp. (1944), 321 U. S. 620, 64 S. Ct. 724, 88 L. Ed. 967.
>
> "Rule 56 should be cautiously invoked to the end that the parties may always be afforded a trial where there is a bona fide dispute of facts between them." Associated Press v. United States (1945), 326 U.S.I., 65 S. Ct. 1416, 89 L. Ed. 2013.
>
> "The procedure for summary judgment was intended to expedite the settlement of litigation where it affirmatively appears upon the record that in the last analysis there is only a question of law as to whether the party should have judgment in accordance with the motion for summary judgment. If there was any question of fact presented on the record in the proceedings for summary judgment, the motion could not be sustained." Elgin J. & E. Ry. Co. v. Burley (1945), 325 U. S. 711, 65 S. Ct. 1282, 89 L. Ed. 1886.
>
> "A litigant has a right to a trial where there is the slightest doubt as to the facts." Peckham v. Ronrico Corp. (1948 C. A. 1st), 171 F. 2d 653, 657.

"We take this occasion to suggest that trial judges should exercise great care in granting motions for summary judgment. A litigant has a right to a trial where there is the slightest doubt as to the facts, and a denial of that right is reviewable; but refusal to grant a summary judgment is not reviewable. Such a judgment, wisely used, is a praiseworthy timesaving device. But, although prompt despatch of judicial business is a virtue, it is neither the sole nor the primary purpose for which courts have been established. Denial of a trial on disputed facts is worse than delay. The district courts would do well to note that time has often been lost by reversals of summary judgments improperly entered." Doehler Metal Furniture Co. v. United States (CCA 2d, 1945), 149 F 2d 130, 135.

". . . To proceed to summary judgment it is not sufficient then that the judge may not credit testimony proffered on a tendered issue. It must appear that there is no substantial evidence on it, that is, either that the tendered evidence is in its nature too incredible to be accepted by reasonable minds or that conceding its truth, it is without legal probative force . . ."

". . . Summary judgment procedure is not a catch penny contrivance to take unwary litigants into its toils and deprive them of a trial, it is a liberal measure, liberally designed for arriving at the truth. Its purpose is not to cut litigants off from their right of trial by jury if they really have evidence which they will offer on a trial, it is to carefully test this out, in advance of trial by inquiring and determining whether such evidence exists." Whitaker v. Coleman (CCA 5th 1940), 115 F 2d 305.

"° ° ° judgment cannot validly be based upon the summary trial by affidavits" and that parties are entitled to have issues of fact tried at trial "through

introduction of exhibits and witnesses produced for direct and cross-examination." Lane Bryant v. Maternity Lane, Ltd. of California (CA 9th 1949), 175 F 2d 559, 565.

So long as the Plaintiff has given some indication that through his newly discovered evidence he may be able to obtain sufficient evidence by deposition or the taking of testimony in open court in order to support his allegations that there was no consideration for the assignments a New Trial is justified. The movant for a New Trial need not prove by his Affidavit that he is entitled to a verdict but merely showing that he has a right to a trial on the merits.

". . . The showing of the alleged newly discovered evidence need not present an air-tight case. It suffices if a showing is made of sufficient new facts to afford a basis for believing that, given an opportunity, the concrete proof could reasonably be expected to cover the gaps and to fill in the details. I believe such a showing has been made here, and it can be left to the matter of proof to supply the specific details." Ishikawa v. Acheson, Secretary of State, 90 F. Supp. 713.

"This remedial procedure, a motion for a new trial based upon after-discovered evidence, is designed to serve the ends of justice." Jones vs. U. S. 279 F 2d 433, cert. den. 81 S. Ct.226, 364 U. S.893, 5 L. Ed. 2d 190.

"To grant a new trial for "newly discovered evidence," the new evidence must be something which was unknown at or before the trial, must have been something which could not have been discovered by reasonable diligence and must be something which in its nature would indicate that a new trial would be more favorable to the movant, and must be ma-

terial and not merely cumulative." U. S. vs. 72.71 Acres of Land, 23 F.R.D. 635, affirmed, Webb vs. U. S. 273 F. 2d 416.
273 F. 2d 416.

In Elliot & Sons v. King & Co., 22 F.R.D. 280, at page 282, it was said that the District Court should order discovery under Rule 27 even though there is an appeal pending.

In the case of Fried v. McGrath, 133 F. 2 350, Judge Edgerton made the hereinafter quoted observation by granting a new trial on grounds not stated in the original motion, which quotation is set forth in Moore's, Vol. 6, page 3850, as follows:

> " 'There is no logical or legal difficulty in granting for one reason a motion made for another reason. And it seems to me a contradiction in terms to say, when a judge grants a party's motion, that he nevertheless acts upon his own motion; or, what comes to the same thing, that he acts of his own initiative. If he grants the party's motion he does not act of his own initiative; and vice versa.' Rule 59(d) clearly expresses this dichotomy: 'the court of its own initiative **may order** a new trial for any reason for which it **might have granted** a new trial on motion of a party . . .' "

In Aetna Casualty & Surety Co. v. Yeatts, 122 F. 2 350, Judge Parker stated as follows:

> " 'To the federal trial judge, the law gives ample power to see that justice is done in causes pending before him; and the responsibility attendant upon such power is his in full measure. While according due respect to the findings of the jury, he should not hesitate to set aside their verdict and grant a new trial in any case where the ends of justice so require.' "

The case of Hagen v. U. S., 9th Circuit, 153 F. 2 850, and Gile v. Duke, 9th Circuit, 5 F. 2 952, the plaintiff was allowed to reopen his case after a nonsuit so as to supply certain defects and omissions in his proof. The fact that the documents in question were recorded in Fallon County would supply a defect, it would give the court an opportunity to reverse its decision on the motion for new trial by granting a new trial in that constructive notice of the recorded rights of the plaintiff would be known to the defendant's predecessors in title. Section 73-201 R.C.M. provides in part as follows:

> "Every conveyance of real property acknowledged or proved, and certified and recorded as prescribed by law, from the time it is filed with the county clerk for record, is constructive notice of the contents thereof to subsequent purchasers and mortgagees; * * *"

In the case of Guerin v. Sunburst Oil & Gas Co., 68 Mont. 365, 218 P. 949, at page 951, it was stated as follows (See Sec. 73-201 and 73-202 R.C.M. 1947):

> "In the instant case the option recorded in the Miscellaneous Record Book was recorded as prescribed by law." Stephen v. Patterson, 21 Ariz. 308, 188 Pac. 131.
>
> "Section 6899, Revised Codes 1921, reads as follows:
>
> "Since the option was an instrument entitled to be recorded, and was recorded as prescribed by law, it imparted constructive notice of its contents to Mrs. Guerin, who was a subsequent purchaser of the property affected by the option, from the time it was filed with the county clerk of Toole County on December 9, 1921. Section 6934, above. One who purchases land from the owner, after the recording

of an option given by the owner to another person to purchase the same land, takes with constructive notice of the option, and cannot claim to be an innocent purchaser. Chesbrough v. Vizard Inv. Co., 156 Ky. 149, 160 S.W. 725. The option recited that the right to purchase given to Rock was 'subject, however, to one certain oil and gas lease given in favor of Gordon Campbell,' and that recital constituted a part of the contents of the option as the term 'contents' is used in section 6934 above. Taylor v. Mitchell, 58 Kan. 194, 48 Pac. 859. But Mrs. Guerin was chargeable also with notice of all material facts which an inquiry suggested by that recital would have disclosed. Fisher v. Bush, 133 Ind. 315, 32 N.E. 924; Loser v. Savings Bank, 149 Iowa, 672, 128 N.W. 1101, 31 L.R.A. (N.S.) 1112; 2 Tiffany on Real Property, § 572. She was bound to make inquiry of the owner of the lease, and, if she failed to do so, she is chargeable with notice of all that she would have learned, if she had pursued the inquiry to the full extent to which it led. Crawford v. Chicago, B. & Q. R. Co., 112 Ill. 319; Gaines v. Summers, 50 Ark. 322, 7 S.W. 301. In other words, she was chargeable with notice of the contents of the Campbell lease, though it was not recorded (White v. Foster, 102 Mass. 375; Hancock v. McAvoy, 151 Pa. 439, 25 Atl. 48; 2 Tiffany on Real Property, § 572), and she could not rely upon the representation by Mrs. Thornton that there was not any outstanding lease upon the property (Bergstrom v. Johnson, 111 Minn. 247, 125 N.W. 899; Waggoner v. Dodson, 96 Tex. 415, 73 S.W. 517; 39 Cyc. 1714)."

In Kelly v. Grainey, 113 Mont. 520, 129 P 2d 619, at 626, it is stated as follows:

"In the words of Chief Justice Brantley in Foster v. Winstanley, 39 Mont. 314, 102 P. 574, 579, 'a bona fide purchaser is 'one who at the time of his

purchase advances a new consideration, surrenders some security, or does some other act which leaves him in a worse position if his purchase should be set aside,' ' etc. Helena & Livingston S. & R. Co. v. Northern Pac. R. Co., 62 Mont. 281, 205 P. 224, 21 A.L.R. 1080; Yale Oil Corp. v. Sedlacek, 99 Mont. 411, 43 P. 2d 887.

"Thus, even if we consider defendant's testimony as showing that she received plaintiff's property from Mae J. Kelly in good faith in consideration for a promise to support their mother, she was not a bona fide purchaser so as to defeat plaintiff's title."

The case of United States v. Viewcrest Garden Apartments, (9th Cir. 1959) 268 F. 2 380, holds that the state recording law governs, and stated thusly (on pages 382 and 383):

"* * * Thus state recording acts interfere with no federal policy as there is no federal recording system for the type of mortgages here involved. It is commercially convenient to adopt existing state systems as it saves the expense of setting up a whole new federal recording system and it enables persons checking ownership interests in property to refer to one set of record books rather than two."

The rule is that any recorded instrument under state law imports notice to any subsequent purchasers or encumbrancers. The recorded contract between plaintiff and McElroy put defendant on notice so that he cannot be a bona fide purchaser.

A partner is charged with knowledge of what the other partner knows. Sec. 63-204 R.C.M. 1947. The terms of the purchase agreement of McElroy on June 17, 1952, are chargeable to Markey. Since Markey is a brother-in-law of appellee Collins Reed, and Buchtel the brother-

in-law of McElroy, it is obvious the chain of title is between business associates and relatives. These parties cannot be bona fide purchasers, especially since they all have notice, actual or constructive, by the recording of the purchase agreement to McElroy, which he assigned to Industrial Gas and which was terminated.

These facts were not known at the time of trial and justice should require complete inquiry into these transfers which appear to be nothing more than a scheme to deprive Mondakota Gas Co. of its oil and gas interests in the Baker Field.

Since present counsel was engaged in this case in December, 1964, many court records have been examined, and in all the Baker Field cases, going back to Federal Power Commission hearings involving the Montana-Dakota Utilities Co., it is noticed that other persons such as Collins Reed herein, are always represented by MDU counsel. The Court knows of the years of litigation between MDU and Capital Gas, Mondakota Gas, John Wight, Inc., and John Wight personally. Will it ever end, or should the Court require, in the furtherance of justice, that discovery into the matter be ordered, to the view of perhaps ending all this litigation, or should the Court permit such schemes as appear in this case to prevail. See briefs of Government counsel (FCC) Lambert McAllister, in case No. 13396, CCA 8th, entitled Montana-Dakota Utilities Co. vs. FCC, Mondakota Gas Co., So. Dakota Pub. Util. Comm., and No. Dakota Pub. Ser. Comm., wherein he stated in his brief, on page 23, as follows:

> "* * * To eliminate this unduly discriminatory 'practice' which enables Petitioner to maintain a monopoly in gas service to North Dakota and Montana points, and likewise discriminatory as to Mondakota Gas Company, the Commission ordered a system-wide rate * * *"

The above case was reported in 169 F. 2 392, decided adverse to MDU, and the U. S. Supreme Court denied cert. reported in 335 U. S. 953, 69 S. Ct. 82, Case 4, on October 25, 1948.

The doctrine of res adjudicata should not have been applied in the instant case because the actions which were dismissed involved parties now deceased, different questions af fact, and different relief from different parties defendant and was in no way an adjudication on the merits of the present controversy. (Tr. p. 224)

Present counsel for the appellant entered that case after it had gone to trial and after a motion for new trial was filed. From review of the records on file herein it is noticed that on August 3, 1964, an Order was filed by the Hon. W. D. Murray wherein he did not disqualify himself pursuant to a request of the general manager of the appellant corporation, who filed the same without assistance of counsel. In view of the request it may be that the trial judge should have disqualified himself, or at least set forth in his order the facts which justify his continuance of hearing the case now before the Court.

> "In federal practice any question which has been presented to the trial court for a ruling and not thereafter waived or withdrawn is preserved." U. S. vs. Hardue Hayaski, 282 F 2, 599, 601.

CONCLUSION

The appellant respectfully contends that on the basis of the record after supplying the proof of the recorded chain of title in the appellant that the trial court, in the aid of the appeal, and in aid of the motion for new trial, should have granted the appellant's motion for discovery procedure. In addition, it would appear that under Rule 56, the trial court could have granted summary judgment, and should have granted summary judgment, in favor of the appellant, Mondakota Gas Co., for the reason that the chain of title, as recorded in the County Clerk and Recorder's office at Fallon County, Montana, shows the interest and ownership of Mondakota Gas Co. and the subsequent purchasers and particularly Collins G. Reed could receive only the interest that E. L. McElroy had and that was taken with notice of the prior recorded rights of the appellant. Appellant respectfully contends that the cause should be reversed and remanded for entry of judgment in favor of the Mondakota Gas Co. to the full extent of the interest sought to be transferred by McElroy to Buchtel to Reed, namely: a full 25% royalty interest instead of merely the overriding royalty interest set forth in page 3 of the judgment.

The motion for new trial seeks to show to the Court that there was fraud, failure of consideration, and actual knowledge of the facts by Reed and his predecessors in his chain of title. This, and the recorded contract, would require the court to reach a different conclusion, i.e.: that plaintiff is entitled to judgment for the entire

interest of the Walker lease, subject only to the operating agreement.

Defendant's title is predicated upon his predecessors title and the title of E. L. McElroy stops at the point of the contract of purchase recorded in Fallon County, Montana, being the common grantor, the appellant herein, which contract was terminated and reinvested appellant with his title.

Respectfully submitted,

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Attorneys for Appellant

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

Daryl E. Engebregson
Attorney for Plaintiff

No. 20402

United States Court of Appeals for the Ninth Circuit

MONDAKOTA GAS COMPANY,
a corporation,

Appellant,

-vs-

COLLINS G. REED,

Appellee.

Brief of Appellee

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United States Court of Appeals
for the Ninth Circuit

MONDAKOTA GAS COMPANY,
a corporation,

Appellant,

-vs-

COLLINS G. REED,

Appellee.

Brief of Appellee

STATEMENT OF JURISDICTION

We agree the Court has federal jurisdiction. Appellant conceded the allegations and proof of fraudulent joinder of the Industrial Gas, Inc., a defunct Nevada corporation. As a result there is diversity of citizenship and the matter in controversy exceeds, exclusive of interest and costs, the sum of $10,000.00 *(Par. IV-IX, Pet. for Rem., R. 2-7; Order denying remand, R. 114; Section 1332, Title 28, U.S.C.A.).*

STATEMENT OF CASE

Appellant's statement of case is not accurate nor sufficient. The United States Oil and Gas Lease described in appellant's complaint was issued as of September 13, 1935, to L. M. Walker, as lessee. L. M. Walker committed the working interest created by said lease to the Co-operative or Unit Plan of Development, Unit No. 5, Cedar Creek Anticline, by means of agreement dated May 26, 1934, by and between the said Walker and Gas Development Company, predecessor in title of original defendant Montana-Dakota Utilities Co. The working interest created by said lease in horizons below 2,000 feet was committed to the terms of an operating agreement dated May 24, 1934, by and between the said Walker and Fidelity Gas Co. In addition to the two agreements hereinabove described, the said Walker entered into gas purchase agreements with Montana-

Dakota Utilities Co. and its predecessor in title, Gas Development Company, dated respectively October 19, 1939, and May 26, 1934. Thereafter and on or about August 25, 1948, and after the above described agreements had been filed with the Bureau of Land Management of the United States Department of the Interior, the said L. M. Walker transferred and assigned all of her right, title and interest in and to said lease to appellant, Mondakota Gas Company, approved by the Bureau of Land Management December 23, 1948. *(See record and transcript, Docket Nos. 15293, 19638, 19639; Ans. this case, R. 116; Stipulation, R. 151-155; R. 135.)*

Appellant does not fairly nor accurately recite the chronology of the documentary evidence upon which the defendants, including the appellee, rely in this case. On motion for new trial, appellant asserts that the terms and provisions of, and claimed termination of, an alleged purchase agreement of June 17, 1952, raises in some mysterious and unexplained manner an issue of fact with respect to the validity of the subsequent assignment of December 5, 1952, upon which appellee relies. In the first place, as shown hereafter, copy of said purchase agreement which conveyed several pages of described lands and leases was never submitted to the District Court before summary judgment. In the second place, as shown by the allegations of the answer in the prior

adjudicated case, Civil 1557, discussed hereafter, the purchase agreement now offered on new trial was not the true agreement executed by the parties, but was falsified by the appellant before it was recorded, and it is a copy of the falsified, recorded agreement which is now asserted. In the third place, even if we were to assume that the agreement offered is the authentic agreement between the parties, and even if copy thereof had been submitted to the District Court before summary judgment, it could not have changed the result in this case. Appellee Reed does not rely on any conveyance to McElroy in the purchase agreement of June 17, 1952, as the source of his title. That purchase agreement has no connection with the appellee Reed. The appellee Reed is relying upon a later, new, and different agreement entirely entered into between appellant and McElroy on December 5, 1952, whereby for an entirely new and different consideration, the appellant assigned to McElroy the isolated federal oil and gas lease here involved, reserving certain overriding royalty rights in the appellant. It should be noted here that the decree in this case protects the appellant's reserved rights in that assignment. In other words, the title of the appellee Reed arises from a clean cut, unambiguous, unequivocal chain of title separate and distinct entirely from the purported purchase agreement of June 17, 1952, and having no connection

with it. Even if we were to assume some connection between the two agreements, the terms and provisions of the original purchase agreement merged into, and are superseded by, the subsequent assignment of December 5, 1952. Accordingly, the purchase agreement of June 17, 1952, even if it had been submitted to the District Court before summary judgment, could not have changed the result in this case.

On December 5, 1952, the appellant assigned interests in Federal Oil and Gas Lease 025001 to one E. L. McElroy, reserving some interest to the appellant *(R. 138)*. This was filed with the Bureau of Land Management on December 12, 1952, and *approved* by the Bureau of Land Management on March 23, 1953. On *May 28, 1953*, McElroy assigned to defendant in this case, L. B. Buchtel, filed with the Bureau of Land Management on August 21, 1953, and *approved* by the Bureau of Land Management *(R. 141)*. *October 28, 1954*, Buchtel assigned to appellee Collins G. Reed, filed with the Bureau of Land Management on November 1, 1954, and *approved* by the Bureau of Land Management on December 1, 1954 *(R. 143)*. These instruments were all set forth in the answer filed in the case *(R. 116)*; they are plain, unambiguous, unequivocal; certified copies thereof were submitted to the court at the pretrial conference *(R. 223)*; copies were again attached to the mo-

tion for summary judgment *(R. 135-143),* and their authenticity and validity were conceded by appellant. From the time the pretrial conference was held until summary judgment they were never challenged *(Dist. Court Order, R. 223-224.)* There was no documentary or other evidence before the Court attacking or questioning or disputing their validity. On the strength of the undisputed, uncontradicted, and admitted evidence before the District Court at the time the summary judgment was decided, the judgment which issued was the only decision which could be reached. The Court was very careful in its decree in this case to reserve to the appellant all interests which the appellant had reserved in the base federal oil and gas lease assignment to McElroy of December 5, 1952 *(see page 3, Judgment, R. 162).* The subsequent assignments from McElroy to Buchtel and from Buchtel to Reed do not involve, nor adversely affect, the interest reserved by the appellant and protected by the decree.

The complaint in this case *(R. 9-12)* attempts to quiet title in the appellant to Federal Oil and Gas Lease No. 025001. On *February 2, 1953,* appellant joined with other plaintiffs in the action known as the Cedar Creek case, and in the third cause of action and fourth cause of action attempted to quiet title in the appellant to the same federal oil and gas lease, 025001. Named as defendants in that Cedar Creek Case were Fidelity Gas

Co., Montana-Dakota Utilities Co., and Shell Oil Co., all named as defendants along with Buchtel and Collins G. Reed in the present complaint. McElroy was not named as a defendant in the Cedar Creek Case, nor were Buchtel nor Reed. The third cause of action and the fourth cause of action in the Cedar Creek Case were identical with the complaint in this case, in which judgment in favor of Fidelity Gas Co., Montana-Dakota Utilities Co., and Shell Oil Co., and against the appellant was rendered, and was affirmed by this Ninth Circuit Court in *249 F.2d 277, Docket No. 15293, certiorari denied, 78 S. Ct. 775.* The third cause of action and fourth cause of action in the Cedar Creek Case can be found at pages 23 to 26 of the transcript in Docket No. 15293. On the day the Cedar Creek trial commenced, counsel representing the plaintiffs advised the Court they desired, and moved, to dismiss causes of action Nos. 3 and 4. The record shows that the Court responded "very well" *(T, P. 231, Docket 15293).* At no place, however, in the subsequent proceedings was there any request by the appellant Mondakota Gas Company to be relieved as a party plaintiff, or dismissed from the Cedar Creek action as a party, nor was there ever any order to that effect. It is significant, because from the time that the appellant joined in the Cedar Creek complaint which was filed on or

about *February 2, 1953,* until the case came on for trial on April 13, 1955 *(T, P. 219, Docket 15293)*, the appellant actively participated as a party plaintiff in all of the preparation for the trial in that case. Not only was the appellant in the Cedar Creek case purporting to quiet title to base lease 025001, but the defendants Fidelity Gas Company, Montana-Dakota Utilities Company and Shell Oil Company (all defendants in the complaint in this case) were vigorously asserting the subsisting validity of all documents before the Court in that case. For that reason, it is important that no order was ever asked for, or given, in the Cedar Creek Case, dismissing the appellant as a party plaintiff. Exactly the same situation pertains as it does in any case where a party plaintiff appears at the trial, puts in no evidence, the defendant puts in evidence, and judgment is then rendered for the defendant. As far as the record in the Cedar Creek Case is concerned, the appellant was still a party to the action when the findings of fact, conclusions of law, and judgment were signed, filed and entered *(Docket No. 15293, T, Pp. 182-199; Pp. 199-201; Pp. 204-205).* The judgment entered and noted in the civil docket in the Cedar Creek Case on *July 3, 1956,* was just as effective against the appellant Mondakota Gas Company as it was against any other plaintiffs in the Cedar Creek Case.

In any event, if not barred by the judgment itself,

the dismissal as to appellant in the Cedar Creek Case was an adjudication on the merits against appellant under *Rule 41(b), Federal Rules of Civil Procedure*, and is now res adjudicata.

No later than *July 25, 1961*, the appellant filed his complaint in this case, Civil No. 354, against Fidelity Gas Company, Montana-Dakota Utilities Company, Shell Oil Company (all defendants in the Cedar Creek Case), L. B. Buchtel and appellee Reed to quiet title in appellant to the same federal oil and gas lease 025001 that was involved in the Cedar Creek Case. Two companion cases, S-W Company v. Fidelity Gas Company, Montana-Dakota Utilities Company, and Shell Oil Company, and The First National Bank of Denver, Colorado, v. Fidelity Gas Company, Montana-Dakota Utilities Company and Shell Oil Company, Civil Nos. 355 and 356, respectively, were consolidated for trial. Summary judgment against the appellant in all three cases was docketed on *August 31, 1964*, more than three years later. Judgment in the two companion cases against the appellant has been affirmed by this Court *(D.C. Mont., 1965, 244 F. Supp. 327; ..... F. 2d ....., Docket Nos. 19638, 19639)*.

The chronology of this action from the time the complaint was filed until the summary judgment was entered more than three years later is of interest. The Court

will quickly note that at all times the appellant was offered by the District Court a full, fair and complete opportunity to present to the District Court all of its claims of every kind and character, and to submit to the District Court any and all evidence which the appellant might offer or assert in support of its position. As indicated above, as of the time the summary judgment was entered, all the documentary evidence before the Court was admitted, conceded, and undisputed. There was no issue of fact as of that time.

July 25, 1961, was the date summons was issued in the State Court, so that the complaint was filed no later than that date *(R. 8).* On *August 1, 1963,* answer was filed. Appellee Collins G. Reed attached photostatic copies of each and all of the documents upon which he relied *(R. 116). August 12, 1963,* order issued calling a pretrial conference for September 16 *(R. 124). August 21, 1963,* the parties stipulated to trade for examination all documents upon which the parties relied *(R. 125).* On *September 6, 1963,* filed September 16, 1963, the appellant by letter to the appellee outlined the documents upon which the appellant might rely. We specifically call to the attention of the Court that in that letter in September, counsel for the appellant indicated that he might rely upon the purchase agreement between McElroy and appellant of June 17, 1952, and complaint

at least in Civil No. 1157, Federal District Court, appellant v. McElroy *(R. 129-130)*. No copy of the agreement was ever submitted to the District Court. Except for the description of the Federal Civil Action No. 1557 contained in an affidavit filed in this case March 21, 1964, describing the dismissal of that action for lack of diligent prosecution *(Vol. 1, P. 173, Transcript, Docket No. 19639)*, the purchase agreement of June 17, 1952, of questionable authenticity, was never again mentioned in the case after the letter of September 6, 1963, in any of the proceedings prior to the date the summary judgment was entered in *August, 1964*. On *September 16, 1963*, a pretrial conference was held. Counsel for the appellant was fully and carefully interrogated concerning the issues, contentions, and proof relied upon. Documents relied upon were submitted to the District Court. No issue of assignment invalidity was suggested. The pretrial order issued *October 22, 1963*. There was no suggestion of any attack on the validity of the base assignment of December 5, 1952, from appellant to McElroy, or the subsequent assignments from McElroy to Buchtel to appellee. On *November 1, 1963*, separate motions for summary judgment were filed by the respective defendants *(R. 131)*. The motion of the appellee Collins G. Reed expressly recognized the prior rights which this appellant had reserved in the assignment of December 5,

1952, which appellant made to E. L. McElroy. Once again, the appellee Reed outlined the documents relied upon by the appellee *(R. 131)*. Copies of assignments were attached -- Walker to appellant *(R. 135)*; appellant to McElroy *(R. 138);* McElroy to Buchtel *(R. 141);* Buchtel to appellee *(R. 143)*. Appellant said in part:

> "The separate motions for summary judgment of defendants, Fidelity Gas Company and Montana-Dakota Utilities Company, are made on the ground that there is no genuine issue as to any material fact with respect to the respective rights and interests of the plaintiffs and these defendants. These motions are made and based upon numerous listed instruments designed, we believe, to establish the rights of the defendants in and under the Fidelity Operating Agreements, certain gas purchase agreements, certain unit agreements for the development of the upper horizon for gas purposes, and the establishment of certain royalty interests in these defendants. Plaintiffs concede that they claim no interest under the gas unit agreements, the gas purchase contracts covering the upper horizon, and that plaintiffs do not dispute the overriding royalty interests involved. As a matter of fact, if all of the former interests of Fidelity and MDU under the Fidelity Operating Agreements, affecting the oil and gas rights below a depth of 2,000 feet were acquired by Shell Oil Company by virtue of its operating agreement with Fidelity and MDU, then it would appear that the issues in these cases are between the plaintiffs and Shell Oil Company. These issues are outlined in plaintiffs' memorandum in support of its motion to amend and modify the pretrial orders, which is filed herewith. As indicated in that memorandum these issues appear to be (1) whether the judgment

> in the Cedar Creek case is res judicata of the rights of the plaintiffs and (2) the rights of the plaintiffs to have the defendants' rights under the Fidelity Operating Agreement terminated by reason of the abandonment of their obligations under Fidelity Agreements because of their failure to comply with the provisions of these agreements. These issues are discussed both in plaintiffs' memorandum in support of their motion to have the trial order modified and in plaintiffs' pretrial memorandum. We feel that it is not necessary to repeat here such contentions and arguments. The Court is respectfully referred to such memorandum and to plaintiffs' pretrial memorandum."

No argument was presented to the district judge suggesting an issue of fact with respect to the assignments. Filed *November 8, 1963,* was a stipulation of October 28, 1963, between the parties in which they submitted to the Court the documents designated therein, waived any foundation, agreed that they could be received in evidence and considered by the Court. It should be noted that the purported purchase agreement of June 17, 1952, now urged in the motion for new trial, was not submitted by the appellant *(R. 151).* On *December 12, 1963,* the appellant filed a motion to modify the pretrial order. In that motion there was no issue raised concerning the validity of the assignment of December 5, 1952, nor suggesting any issue of fact by reason of the purchase agreement of June 17, 1952, nor questioning the validity of the assignments from McElroy to Buchtel to Reed. On *March 21, 1964,* affidavit was filed in

support of motion for security for costs which pointed up the prior aborted attack by appellant against McElroy in United States District Court Civil No. 1557 *(Vol. 1, P. 173, Transcript Docket No. 19639). April 8, 1964,* an order set all motions for hearing at 2:00 P.M. on April 27, 1964 *(R. 155).* Briefs were filed by the appellant in support of his motion to modify the pretrial order, and opposing the motions for summary judgment. It is significant that at no time in any of those briefs did the appellant assert any reliance upon the purchase agreement of June 17, 1952, nor question the validity of the subsequent assignments from McElroy to Buchtel and from Buchtel to Reed. As a matter of fact, the position taken by the appellant as of that date is described in the order of District Judge W. D. Murray denying the motion for new trial as follows:

> "This attempt to question the validity of the assignment from the plaintiff to McElroy is made in this case for the first time on the motion for a new trial. The validity of the assignment to McElroy was not mentioned as an issue in either the pretrial order filed October 23, 1963, or the plaintiff's motion to modify the pretrial order which was filed December 12, 1963. As a matter of fact, at a pretrial conference, plaintiff's then counsel conceded that the title of all of the defendants in this and the two companion cases was settled by the decision of this court in Cedar Creek Oil and Gas Company, et al., v. Fidelity Gas Co., et al., which was affirmed by the Court of Appeals in 249 F. 2d 277. At that pretrial conference the attorney for the plaintiff

> stated that plaintiff in this and the two companion cases was relying on breaches of the Fidelity operating agreements which were alleged to have occurred subsequent to the final judgment in the Cedar Creek Oil and Gas case. The attack on the validity of the assignment of the Walker lease by the plaintiff to McElroy for the first time on the motion for a new trial appears to be an afterthought and that reason alone would warrant the denial of the motion for a new trial." *(R. 223-224)*

August 3, 1964, order granting the motions for summary judgment was issued. *August 13, 1964*, notice of form of the proposed judgment was served on the appellant and filed . Note that no objection was ever made or filed by the appellant, and nothing was indicated by appellant that he was relying on invalidity of the base assignment or subsequent assignments *(R. 157)*. *August 20, 1964*, notice of amended form of judgment was served, and again there was never any objection filed by the appellant to the form of judgment, or suggesting or indicating any reliance on the gas purchase agreement of questionable authenticity of June 17, 1952 *(R. 158-159)*. *August 31, 1964*, judgment in the form served was signed, filed and entered, granting to this appellant all rights which this appellant had reserved in its prior assignment of December 5, 1952, to McElroy. The subsequent assignments from McElroy to Buchtel and Buchtel to Reed could not, and do not affect or disturb those prior rights of the appellant fully protected as indicated *(R. 160-164)*.

The foregoing chronology illustrates clearly that during the more than three years between the time the complaint was filed in this case on *July 25, 1961,* and the date when the summary judgment was entered on *August 31, 1964,* the appellant at all times had a full, fair and complete opportunity to present to the District Court any and all claims the appellant might have of every kind and character, and to present to the District Court any and all evidence upon which it relied. It is clear from the foregoing chronology that if the appellant at the start of the case could legally claim or was claiming invalidity of the assignment of December 5, 1962, by reason of the alleged termination of the purchase agreement of June 17, 1952, adjudicated against the appellant in both the Yellowstone District Court action, and the Federal District Court Civil No. 1557, he abandoned any such claims, and never at any time thereafter asserted or relied upon them. Instead he admitted and conceded to the District Court the validity of all documents before the Court and said he was relying instead on alleged defaults in performance under the base federal oil and gas lease subsequent to the date of the Cedar Creek judgment entered July 3, 1956. Upon the admission by the appellant that it had never served on any of the defendants any written notice of default, or any other claim of default, the District Court properly granted summary

judgment to all defendants (*244 F. Supp. 327, later affirmed by this Court, ... F. 2d .....; Docket Nos. 19638 and 19639*).

A. *Motion For ~~Summary Judgment~~ NEW TRIAL.*

On *September 9, 1964*, through new and different counsel, appellant attacked the summary judgment claiming an issue of fact with respect to the validity of the assignment of December 5, 1952, from appellant to McElroy (*R. 165*) by reason of the alleged termination of the purchase agreement of June 17, 1952, between appellant and McElroy. In view of the chronology in this case outlined above, and the additional chronology discussed hereafter, the suggestion in the motion for new trial that appellant was presenting new evidence which he could not have discovered and presented with reasonable diligence is fantastic and incredible. Keeping in mind as outlined above, appellant suggested in a letter of September 6, 1963, he might rely in this case on a purchase agreement of June 17, 1952, between appellant and McElroy, and on the complaint at least in Civil No. 1157, appellant never thereafter before summary judgment submitted copy of any such agreement to the Court for consideration, nor indicated he was relying upon it. It was never offered or submitted at the pretrial conference; never mentioned in the pretrial order, nor the motion to modify the pretrial order, nor the memo-

randum submitted therewith; nor in the briefs or proceedings for summary judgment. In truth and in fact, of course, the one has no bearing or effect upon the other.

On *August 18, 1953,* eight years before complaint was filed in this case, appellant filed a complaint in Cause No. 27622 in Yellowstone County, Montana, against the same E. L. McElroy, one E. A. Markey and others *(R. 71-77).* On *November 4, 1953,* appellant filed the same form complaint against the same McElroy, and the same Markey in Civil No. 1557 in the Federal District Court *(R. 13-19).* Each complaint attached as an exhibit the purchase agreement of June 17, 1952, alleged breaches of its terms by McElroy, alleged on information and belief assignments of interests to co-defendants, prayed for a decree cancelling the purchase agreement, and transfers to the co-defendants. *Note:* The assignment of December 5, 1952, from appellant to McElroy, clean cut and unambiguous in its terms, and the subsequent assignment from McElroy to Buchtel, preceded the commencement of those two cases attacking the validity of the purchase agreement of June 17, 1952. Likewise, their filing and approval by the Bureau of Land Management preceded the start of these two cases. Neither complaint referred to, nor attacked the validity of the assignment of December 5, 1952. The purchase agreement of June 17, 1952, has no

connection with the subsequent assignment of December 5, 1952, so that even if it had been presented to the District Judge in this case before summary judgment, it could not have affected the result. Furthermore, the Yellowstone County action was dismissed on *December 16, 1963*, for failure of appellant to prosecute *(R. 113)*, a judgment against appellant on the merits as far as his right to cancel or terminate the purchase agreement was concerned *(Rule 41(b), M.R.C.P.)*. The Court should notice the allegations of the answer filed in this Federal District Court case No. 1557 *(R. 58-62)* which specifically denied the validity and authenticity of the gas purchase agreement of June 17, 1952, and its amendments; which alleged that after the agreements were executed, the appellant had altered those agreements before recording them by substituting pages of land description. On *February 18, 1959*, the Montana Federal District Court ordered the appellant plaintiff to either file a motion within thirty days for leave to file an amended complaint, or to dismiss as to all defendants except McElroy, or any person substituted for McElroy *(R. 63)*. On *March 17, 1959*, the appellant filed a praecipe *(R. 64)* as a result of which on *March 23, 1959*, there was an order dismissing as to all defendants except McElroy *(R. 65)*. When as of *October 11, 1961*, no motion had ever been made by the appellant for the

substitution of a successor or representative of deceased McElroy, the District Court entered an order dismissing because of failure to diligently prosecute the case *(R. 66)*. This is an adjudication against the appellant on the merits under *Rule 41(b), F.R.C.P.,* including the denial of the authenticity of the agreement and its falsification before recording.

On *March 9, 1954,* John Wight filed an affidavit with the Bureau of Land Management of the United States claiming defaults in the terms of the purported gas purchase agreement of June 17, 1952 *(see Exhibit B-10, R. 4)*. The record does not disclose whether that administrative remedy was exhausted. The same claims of course, were involved in the Yellowstone County State District Court action, and in Federal Civil No. 1557, both of which are described above.

The claim of newly discovered evidence of which he was unaware, and unable to present with diligence is indeed fantastic.

This complaint was filed *July 25, 1961.* Pretrial conference was held *September 16, 1963.* Motion for summary judgment was filed *November 1, 1963.* Order granting issued *August 3, 1964,* and judgment was entered *August 20, 1964.* Mailed *June 3, 1965,* by still newer and different counsel was a second motion to amend the motion for new trial by incorporating the

record of a 1965 default judgment against Industrial Gas, Inc. What possible connection could it have with this case? Neither McElroy, Buchtel, nor Reed were defendants. Industrial Gas, Inc., was fraudulently joined as a defendant in this case *(Pet. to Rem., R. 2-7)*. Appellant on hearing of motion to remand so conceded *(Order Deny. Remand, R. 114-115)*. What possible application does the default judgment in a state court in late 1965 against Industrial Gas, Inc., have with this case? There was never any connection between McElroy, Buchtel, and appellee Reed on the one hand, and Industrial Gas, Inc., on the other.

Not only is Wight's claim of "newly discovered evidence of which plaintiff was ignorant at the time of trial herein, and which he could not have sooner discovered in the exercise of diligence" fantastic and incredible, it could not have any bearing on the merits, as shown above, and it was so speculative and conjectural substance-wise, that no district court court could accept it. From 1953 during which appellant filed three separate cases to *August 31, 1964*, date of judgment, appellant was involved in litigation concerning this very lease. Appellant waited until *September 9, 1964*, through new and different counsel, to change the position he had taken before judgment in the District Court, and to request what would constitute harassing discovery, on the ground of

"newly discovered evidence of which plaintiff was ignorant at the time of trial herein and which he could not have discovered in the exercise of due diligence." Hearsay affidavit of Robert Kelleher, Esq., and hearsay, self-serving, affidavit of John Wight, filed September 9, 1964, in support of the motion for new trial, suggest that Wight, alleged president of the appellant, had previously learned from a reliable source that Buchtel was the brother-in-law of deceased McElroy; that on September 5, 1964, *by means of a telephone call,* he learned that appellee was a brother-in-law of said E. A. Markey; that Markey was alleged to be a one-time partner of McElroy *(Paragraph III of the 1953 Yellowstone County complaint so alleges, R. 73)*; that Markey was a brother-in-law of appellee Reed; that

> "Affiant further *suspected but had no proof* that there was no consideration for the assignment from Buchtel to Reed" *(Emphasis supplied; R. 173)*;

that *"affiant believed"* that Reed *"may have had"* an economic interest in the partnership of Markey and McElroy; *that affiant believed* that if the court would grant leave to take depositions of Buchtel, Markey, and Reed, that *then* sufficient evidence *could be obtained* to prove that there was no consideration for the assignments from McElroy to Buchtel to Reed. It was further claimed that appellant was prepared to submit evidence of lack of consideration of the base assignment of December 5,

1952, but *was prevented from doing so* because a motion for summary judgment was filed, heard, and granted *(R. 168)*.

At the time set for the hearing on the motion for new trial, *March 16, 1965*, a motion for continuance and discovery through income tax returns was presented by still newer and different counsel, wholly unsupported. Mailed *April 21, 1965,* was a motion to amend the motion for new trial. Mailed *June 3, 1965,* was a second motion to amend the motion for new trial incorporating the record of a state court default judgment against defunct Industrial Gas, Inc., the corporation originally fraudulently joined as a defendant in this case. Appellee Reed was not a party to that action. Appellant conceded in this very case Industrial Gas, Inc., was fraudulently joined *(Pet. Rem., R. 2-7; Order Deny. Remand, R. 114-115)*. The chain of title in this case was not involved. It has no competence or relevance.

It was not until *September 9, 1964,* that appellant contended through new and different counsel on motion for new trial, as pointed out in the order denying the new trial, that:

> "This attempt to question the validity of the assignment from plaintiff to McElroy is made in this case for the first time on motion for new trial * * *. The attack on the validity of the assignment of the Walker lease by plaintiff to McElroy for the first time on the motion for a new trial appears to

be an afterthought and that reason alone would warrant denial of the motion for new trial." *(R. 223)*

The District Court also felt the dismissal for lack of prosecution of Cause No. 1557 commenced in 1953 in Federal District Court, in which appellant sought cancellation of the June 17, 1962, agreement from appellant to McElroy, was an adjudication against appellant on the merits under Rule 41(b); that since the decree protects appellant's rights reserved in the base assignment of December 5, 1952, the subsequent assignments from McElroy to Buchtel to Reed are of no concern to appellant; and that the discovery requested, as well as the newly discovered evidence, pertain to the issue of the validity of the subsequent assignments, and would not assist appellant. *(R. 224)*

This chronology of events demonstrates conclusively why the appellant has never had any basis in fact or law to invoke the discretion of the District Court to grant a new trial in the first instance. Appellant wholly failed to prove any of the essentials for either granting a new trial, or for permitting the requested harassing, discovery witch-hunt. Furthermore, appellant's request that this Court find abuse by the District Court in its discretionary action is totally unsupported in fact and law.

ARGUMENT

When a motion for summary judgment is made, it is

incumbent upon the adverse party to immediately come forth with specific facts showing that there is a genuine issue for trial. No such showing was made prior to judgment in this case by the appellant. The failure of the adverse party to so respond requires that summary judgment shall be entered against him. Appellant as of the date of summary judgment conceded the validity of all documents then before the Court, and was relying upon claimed defaults in operation subsequent to the date of the Cedar Creek judgment, already adjudged against appellant and affirmed *(D.C. Mont. 1965, 244 F. Supp. 327, ...F. 2d ....., 9th C.C., Docket Nos. 19638, 19639).*

(Rule 56 (e), F.R.C.P.);

(First National Bank v. First Bank Stock Co., 1962, 9th C.C., 306 F. 2d 937.)

In this connection, this Court has said:

> "Counsel for appellant then states because this is an important case, he should be excused for his failure to file opposition to the motion to dismiss, and for summary judgment * * *
>
> "The court below properly, in the exercise of its judicial discretion, granted the motions before it. There was no opposition, either in writing or orally to the facts presented by appellees. Counsel for litigants, no matter how 'important' their cases are, cannot themselves decide when they wish to appear, or when they will file those papers required in a law suit. Chaos would result. 'Attorneys should make an attempt to conform to the rules and not try to improvise new practice.' (Citing case.) There must be some obedience to the rules of court; and some

respect shown to the convenience and rights of other counsel, litigants, and the court itself.

"Finding no error, we do not reach a consideration of the merits of appellant's claim. We find no abuse of discretion in the trial court's refusal to reopen."

(Smith v. Stone, 1962, 9th C.C., 308 F.2d 15 at 18.)

As pointed out by the District Court, appellant conceded the validity of the base agreement prior to the date the summary judgment was entered. The District Court was, of course, thoroughly familiar with each and every detail of the proceedings taken in that court. In this connection, this Court has said:

"Even in the absence of specific record support we would be inclined to rely upon a district court's interpretation of a stipulation arrived at during pretrial proceedings and approved by the court."

(Likins-Foster Monterey Corporation v. United States, 1962, 9th C.C., 308 F. 2d 595 at 599.)

In several decisions, this Court has spelled out the general rules which preclude relief for the appellant in this case:

a. "Litigants are required to be reasonably alert at trial in the protection of their own interests. If this record could be said to show reasonably genuine surprise on the part of appellants, the remedy would have been to ask for a continuance to allow appellants to 'gather their wits' and prepare for the presentation of rebuttal testimony. (Citing case.) Having failed to do this, and having permitted the cause to go to judgment, it is too late to seek an opening

up of the issues, no proper grounds appearing. (Citing case.)

"Even where it is asserted that the additional evidence asked to be received is newly discovered, the movant must show that he failed to discover that evidence earlier although he exercised due diligence. (Citing cases.) And where, as here, the evidence is not newly discovered, the movant must show that it was for some reason beyond his reach at time of trial. (Citing case.) In the instant case, the named new witnesses, being employees or close acquaintances of appellants, were at all times readily available.

"Another consideration indulged in passing on a motion for new trial is whether the grounds offered suggest a substantial chance of reaching a different result in a new trial. (Citing case.) The proffered testimony is circumstantial and it is doubtful that it would have influenced the court to the extent of rendering a different judgment.

"Important elements of this case are strikingly similar to those of a case which appellants have cited, which states well the general rules:

" 'There is nothing to indicate that any of the parties whose testimony the garnishee now seeks to present to the court were at the time of the trial in any wise incapable of appearing or beyond the reach of the garnishee. Indeed, the parties from whom additional evidence would be elicited are persons who are and have been readily available to the garnishee.' Rue v. Feuz Const. Co., D.C. 1952, 103 F. Supp. 499, 502."

(Moylan v. Siciliano, 1961, 9th C.C., 292 F. 2d 704 at 705-706.)

b. "Appellants' motion for a new trial upon the ground of newly discovered evidence was denied by the district court for lack of diligence. The motion is directed to the sound discretion of the trial

court and is not ordinarily reviewable except where that discretion has been abused. We do not find such abuse here. Over seven months had elapsed between the filing of the action and the date of trial, and another four months elapsed prior to judgment, without the production of new evidence. Indeed, new evidence was not offered until after new counsel had been substituted by appellants at a time when, as the district court pointed out, appellants had already had their day in court."

(Pacific Contact Laboratories, Inc. v. Solex Laboratories, Inc., 1954, 9th C.C., 209 F.2d 529 at 533, cert. den. 75 S. Ct. 26.)

c. "It is also well settled that motions for new trial are addressed to the sound discretion of the court, and orders denying them are not reviewable on appeal in the absence of clear abuse of discretion. (Citing cases.) Allegedly newly discovered evidence which would not materially change the result and which is in large part not newly discovered at all is not ground for a new trial. (Citing cases.)

"'Newly discovered evidence' within Civil Procedure Rule 59, 28 U.S.C.A. following section 723c, refers to evidence of facts existing at time of trial, of which aggrieved party was excusably ignorant. (Citing cases.) * * * The application for a new trial will be denied where it appears that the degree of activity or diligence which led to the discovery of the evidence after the trial would have produced it had it been exercised prior thereto. 39 Am. Jur. §161, p. 168."

(United States v. Bransen, 1944, 9th C.C., 142 F.2d 232 at 235.)

We have read all statutes and cases cited in the brief of appellant. We have no quarrel with their abstract statements of law. None of them, however, have considered or applied facts such as appear in this case, nor

would they have differed from the rulings of the District Judge if they had. One case from appellant's brief summarizes the reasons why the District Judge was compelled to rule as he did in this case.

> "To grant a new trial for 'newly discovered evidence,' the new evidence must be something which was unknown at or before the trial, must have been something which could not have been discovered by reasonable diligence and must be something which in its nature would indicate that a new trial would be more favorable to the movant, and must be material and not merely cumulative."
>
> *(U.S. v. 72-71 Acres of Land, 23 F.R.C. 635, affirmed, Webb v, U.S., 1960, 4th C.C., 273 F.2d 416.)*
>
> *(App. Br., Pp. 10-11.)*

In this case, all the evidence suggested in the request for new trial was known for years before trial; it was in the possession of appellant; it does not suggest or indicate that a new trial would change the old result; and it is for the most part not competent or material.

Appellant states that in *Elliot & Sons v. King & Co., 1957, D.C., N.H., 22 F.R.D. 280,* "* * * it was said that the District Court *should* order discovery under Rule 27 even though there is an appeal pending" *(emphasis supplied) (App. Br., P. 11).* The opinion says no such thing. The opinion states: "Rule 27(b) is discretionary with the court." Whether that discretion should be exercised, of course, depends on the facts of

each case. It certainly was not warranted in this case on the showing made.

All other cases cited by appellant are equally inconclusive. It would unduly extend this brief to discuss them. Suffice it to say, they do not warrant a different result in this case.

Nothing has ever been presented to the District Judge, nor to this Court, indicating in what way the purchase agreement of June 17, 1952, if valid, affects this case; nor in what way its termination would affect this case; nor in what way its termination would affect the validity of the clean cut, unambiguous assignment of December 5, 1952; nor in what way constructive notice of its contents has any bearing; nor why it was never asserted to the District Judge at pretrial conference or any subsequent stage of the case before the summary judgment issued. In any event the dismissal for lack of prosecution by the State District Court of the 1953 action against McElroy and Markey is an adjudication on the merits that no grounds existed for terminating the questionable purchase agreement of June 17, 1952. In *Rule 41(b), Montana Rules of Civil Procedure* it is provided:

> "* * * Unless the Court in its order for dismissal otherwise specifies, a dismissal under this subdivision and any dismissal not provided for in this rule, other than a dismissal for lack of jurisdiction or for lack of an indispensable party, operates as an adjudication on the merits." (It is the same as *(41(b), F.R.C.P.)*

Likewise, the dismissal of Civil No. 1557 by the Montana United States District Court of the 1953 action against McElroy and Markey has the same effect. It was in this case the answer denied the authenticity of the document, and alleged specifically the falsification and alteration by appellant of the purchase agreement prior to recording. The falsified agreement is the one now before the court. The dismissal with prejudice is res judicata on this issue. *(Rule 41(b), F.R.C.P.)*

It is a fundamental rule that a judgment on the merits is conclusive as to all matters which might have been litigated under the issues raised by the pleadings, and as to any other issues actually litigated, although outside of those raised by the pleadings; that the facts pleaded as well as the law applicable pass under the rule of things adjudicated, and the party against whom such adjudication proceeds, as well as his privies and representatives, are thereby barred from again asserting the same facts in another action pertaining to the subject as effectively as though such facts were found from the proof or admitted ore tenus in the course of the trial.

50 C.J.S. at page 168; at page 206;

Sherlock v. Greaves, 1938, 106 Mont. 206 at 214, 76 P.2d 87 at 90;

Missoula Light & Water Company v. Hughes, 1928, 106 Mont. 355 at 366, 77 P.2d 1041;

Kleinschmidt v. Binzel, 1894. 14 Mont. 31 at 52-53, 35 Pac. 460;

Libin v. Huffin, 1950, 124 Mont. 361 at 363, 224 P.2d 144;

Dern v. Tanner, 9th C.C., Mont., 1938, 96 F. 2d 401 at 404-405; cert. den. 59 S. Ct. 82.

As indicated by the District Court, the validity or invalidity of the subsequent assignments from McElroy to Buchtel to appellee Reed has no relevance or bearing whatsoever upon appellant's prior rights. The prior rights reserved to appellant in the assignment of December 5, 1952, are protected in the decree. Plaintiff in a quiet title action must rely upon the strength of his own title, and not on the weakness, if any, of his opposition.

Hinton v. Staunton, 1951, 124 Mont. 534, 228 P.2d 461.

In Montana, a party is estopped by the terms and provisions of a deed under which he claims title, and upon which he relies for title. He is never estopped by such a deed when he claims under a separate or different title which is paramount. In this case, the title of appellee Reed has never arisen out of nor stemmed from the purchase agreement of June 17, 1952, even if it were authentic or competent. The title of appellee Reed stems from the later, newer and different agreement, the assignment of December 5, 1952. Even if the

purchase agreement had been the true agreement between the parties instead of a falsly recorded document, and even if it had been submitted to the District Court, and even if appellant had not conceded to the District Court the validity of the assignment of December 5, 1952, the purchase agreement could not have changed the result in this case.

Hart v. A.C.M., 1924, 69 Mont. 354, 222 Pac. 419.

In any event, the terms and provisions of the purchase agreement would have become merged in, erased by, and supplanted by the terms and provisions of the later clean cut, unambiguous provisions of the assignment of December 5, 1952, approved by the Bureau of Land Management.

Humble v. St. John, 1925, 72 Mont. 519 234 Pac. 475.

CONCLUSION

The degree spells out and protects whatever rights appellant retained by the reservations in the base assignment of December 5, 1952, from appellant to McElroy. There never was any basis for appellant to question the validity of that agreement. If there ever was an issue of fact with respect to the validity of the assignment of December 5, 1952, the appellant was compelled to disclose it to the District Court before summary judgment, instead of accepting and conceding its validity as was

done in this case. The motion for new trial invoked the sound discretion of the District Court, and the order of denial is not reviewable save for a clearly demonstrated abuse of discretion. It is apparent the District Court found appellant's assertion of newly discovered evidence which appellant failed to discover or pursue or present, and could not do so in the exercise of due diligence, fantastic and incredible in face of the chronological history outlined above. The change in position after summary judgment, the submission to the court after summary judgment of a falsified document which obviously could have been submitted before, and the fact that the document even if it had been submitted could not have changed the result, did not warrant the grant of a new trial by the District Judge in the first place. Appellant's request to this Court to find abuse of discretion by the District Court is equally incredible in light of the foregoing record. The fact background of this case as outlined above, in light of the authorities outlined above, certainly does not warrant a reversal by this court of the discretion vested in, and exercised by, the District Judge.

Respectfully submitted,

CROWLEY, KILBOURNE, HAUGHEY, HANSON & GALLAGHER

By CALE CROWLEY
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Collins G. Reed

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

CALE CROWLEY
One of the Attorneys for the
Appellee Collins G. Reed

Reply Brief of Appellant

United States Court of Appeals

for the Ninth Circuit

No. 20402

MONDAKOTA GAS COMPANY, a corporation,

Appellant,

vs.

COLLINS G. REED and
MRS. COLLINS G. REED, et al,

Appellees.

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Reply Brief of Appellant

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REBUTTAL ARGUMENT

The Statement of the case found in Appellee's answer brief is inaccurate and misleading. It is an attempt to confuse this Honorable Court by referring to matters not in this record on appeal and to infer that because appellee alleges something it is proven without any facts to support it.

The Appellee states in its brief that the agreement of June 17, 1952, between Appellant and McElroy was never before the trial court. This is contradictory as he then states on page 18 of his brief "Each complaint attached as an exhibit the purchase agreement of June 17, 1952,°°°", and appellee relies on this to support the decree.

The trial court **knew** the agreement between appellant and McElroy was recorded in Fallon County. Any attempted transfer by McElroy is subject to the terms of the recorded agreement.

Another example of appellee's double-talk is clearly shown where it is stated that Reed obtained the new separate assignment from McElroy on December 5, 1952. The question of failure of consideration has always been present, as has the fact the assignment was never recorded, as is clearly pointed out by the affidavits of Smith and Hutchinson (Tr. Vol. 1A, pages 216-219) showing the fraud and deceit of McElroy.

The action against McElroy was dismissed because a new agreement was reached which rendered the case moot, i.e., McElroy assigned everything he had to Industrial Gas Co., (Tr. Vol. 1A, pg. 230, lines 7-19), and trial was set down on the calendar and judgment entered

presented to the Bureau of Land Management, and this was known by Appellee. The recording precedence is in the State records. (**U.S. v. Viewcrest Garden Apts. [9th Cir. 1959] 268 F2d 380, pages 382-383.)**

The trial Court should have granted discovery to Appellant in aid of its motion for new trial and appeal so that the truth of the fraud and deceit of the relatives and business partners was disclosed. Justice requires this so that the court cannot be used to perpetrate a fraud.

The attempted transfers from McElroy to Buchtell (May 28, 1953—Tr. Vol. 1A, p. 161, line 25) and Buchtell to Reed (October 24, 1954—Tr. Vol. 1A, p. 161, line 28), are subsequent to the agreement between Appellant and McElroy (dated June 15, 1952—recorded January 12, 1953—Tr. Vol. 1, p. 57 and Tr. Vol. 1A, p. 180) was recorded and the appellee cannot be a bona fide purchaser. The trial court should have granted a new trial and entered judgment in favor of appellant.

Respectfully submitted,
DARYL E. ENGEBREGSON
Attorney for Appellant

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing brief is in full compliance with those rules.

DARYL E. ENGEBREGSON
Attorney for Appellant

No. 20416

United States Court of Appeals

FOR THE NINTH CIRCUIT

DRAGOR SHIPPING CORPORATION, a corporation, formerly Ward Industries Corporation,

Appellant,

vs.

UNION TANK CAR COMPANY, a corporation,

Appellee.

OPENING BRIEF OF APPELLANT, DRAGOR SHIPPING CORPORATION

Upon Appeal from the District Court of the United States for the District of Arizona

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No. 20416

United States Court of Appeals

FOR THE NINTH CIRCUIT

DRAGOR SHIPPING CORPORATION, a corporation, formerly Ward Industries Corporation,

Appellant,

vs.

UNION TANK CAR COMPANY, a corporation,

Appellee.

OPENING BRIEF OF APPELLANT, DRAGOR SHIPPING CORPORATION

Upon Appeal from the District Court of the United States for the District of Arizona

---

The defendant-appellant, DRAGOR SHIPPING CORPORATION, formerly known as WARD INDUSTRIES CORPORATION (and hereinafter designated as "Dragor"), appeals (1) from a final judgment for the sum of $1,037,500.00 made and entered against it on June 1, 1965 by the United States District Court for the District of Arizona, Tucson Division, in favor of plaintiff-respondent, UNION TANK CAR COMPANY (hereinafter designated as "Union"); and (2) from an order of the said District Court made and entered on February 2, 1965 which denied the appellant's motion to quash, vacate and annul the service of process upon it in this cause (R. pp. 163-164*).

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* Unless otherwise noted, all page references are to the pages of the Record on Appeal.

Jurisdictional Statement

Jurisdiction of the appeal exists under and by virtue of Sections 1291 and 2107, Judicial Code, Title 28, U.S.C. The jurisdiction of the District Court over the person of the appellant and the subject matter of the action was challenged and contested in the Court below.

Statement of the Case

The within action was purportedly commenced on December 24, 1964 by the plaintiff, a New Jersey corporation with its principal office in the State of Illinois, against the defendant, a Delaware corporation with its principal office in the State of New York. In its complaint, the plaintiff alleged that the defendant had breached an agreement of settlement and the non-negotiable promissory note issued by the defendant thereunder, both of which were executed and delivered by and between the plaintiff and the defendant in the State of New York on October 3, 1963. The liability of the defendant under the aforesaid settlement agreement and promissory note did not arise, and by its terms could not arise, until September 30, 1964.

Service of process upon the defendant was sought to be effected by service upon the Arizona Corporation Commission (R. pp. 12-14), ostensibly under the terms and provisions of Section 10-481 (a) (2) of the Arizona Corporation Statutes. That section authorizes the service of process upon the Arizona Corporation Commission, after a foreign corporation has voluntarily withdrawn from the State of Arizona, in an "action arising out of or involving business done or transactions arising in this State . . ." No process was ever served personally upon the defendant-appellant within the territorial confines of the State of Arizona.

The appellant Dragor, had formally withdrawn from the State of Arizona and terminated the authority of its statutory agent in Arizona to accept service on its behalf

on April 30, 1964, approximately five months before the plaintiff's cause of action allegedly arose and approximately eight months before the purported service of process upon the Arizona Corporation Commission in this case.

The appellant appeared specially to quash, vacate and annul the service of process upon it and to contest the jurisdiction of the Arizona District Court over its person and thereby the subject matter of the action. The appellant's motion to quash the service of process and dismiss the complaint was denied by the Arizona District Court on February 2, 1965, without opinion. Subsequently, the appellant was compelled to file its answer which set forth, among other things, a compulsory counterclaim. It alleged in its answer that it was not thereby waiving its special appearance or its constitutional objections to the jurisdiction of the District Court. The plaintiff-appellee thereupon moved to dismiss the compulsory counterclaim as insufficient in law and for a judgment on the pleadings upon the plaintiff's complaint. Although the District Court denied the appellee's motion to strike the compulsory counterclaim, it granted the motion for judgment on the pleadings, even before the pleadings were closed by the filing of the plaintiff's reply. A judgment in favor of the appellee Union against the appellant Dragor for the sum of $1,037,500.00 was made and entered by the District Court on June 1, 1965.

Within the time prescribed by law, the defendant-appellant filed its notice of appeal to this Court, accompanied by a bond for costs on appeal. Thereafter, it filed a supersedeas bond for the total amount of the judgment. The record on appeal was filed in this Court on September 24, 1965, and docketed on October 5, 1965, within the time prescribed by law.

The Issues Presented By This Appeal

As appears from the complaint, the plaintiff-appellee's cause of action is based upon the defendant-appellant's alleged breach of a settlement agreement and a non-nego-

tiable promissory note maturing on September 30, 1964 issued by the defendant-appellant thereunder, both of which were executed, issued and delivered by and between the plaintiff and the defendant in the State of New York on October 3, 1963. This appeal thus presents for this Court's review the validity of the District Court's assumption of jurisdiction over the subject matter of this action and the person of the appellant, a Delaware corporation which was neither qualified to do business, nor was actually engaged in doing business, in the State of Arizona for many months prior to September 30, 1964, when the plaintiff's cause of action allegedly arose. It likewise presents for this Court's review the validity of the District Court's action in refusing to quash the service of process upon the Arizona Corporation Commission in a suit against the appellant upon a cause of action which arose in the State of New York many months after the appellant had formally withdrawn from the State of Arizona.

The resolution of the issues thus presented by this appeal requires a determination of whether, under the recent decisions of the United States Supreme Court defining the constitutional limitations upon a state's assumption of jurisdiction *in personam* over non-residents, i.e., *International Shoe Co.* v. *State of Washington,* 362 U. S. 310; *McGee* v. *International Life Insurance Co.,* 335 U. S. 220; and *Hanson* v. *Denckla,* 357 U. S. 235, the Arizona District Court could lawfully, validly and constitutionally exercise an *in personam* jurisdiction over the defendant-appellant Dragor, a non-resident Delaware corporation, neither qualified to do business nor doing business in the State of Arizona, upon a cause of action accruing in the State of New York to enforce an obligation created solely by documents executed, delivered and allegedly breached in that state.

To apprehend the factual and legal scope of the issues posed by this appeal, we turn to a review of the proceedings before the Court below.

The Plaintiff's Complaint

The plaintiff's complaint contains two counts (R. pp. 2-11).

In its first count, the plaintiff alleges that it is a *New Jersey corporation* with its principal place of business in the *State of Illinois;* that the defendant is a *Delaware corporation* with its principal place of business in the *State of New York;* and that the matter in controversy exceeds the sum of $10,000.00 (R. p. 2).

It is further alleged that, on October 3, 1963, the defendant and the plaintiff executed a contract encaptioned "Agreement of Settlement" annexed to the complaint as Exhibit A (R. pp. 2, 5-9). That agreement provided, in part, that the appellant would pay to the respondent, "on or before September 30, 1964 the sum of One Million ($1,000,000) Dollars with interest at the rate of Five (5%) Per Cent per annum commencing from January 1, 1964, *which sum shall be evidenced by a non-negotiable promissory note*" of Dragor payable to the order of Union (R. p. 7). It is further alleged that the defendant failed to pay the sum of $1,000,000 "*when it became due as provided in said Agreement of Settlement*" and that such sum is due and owing from the defendant (R. p. 3).

In its second count, the plaintiff alleges that, on October 3, 1963, the defendant "*made, executed and delivered a promissory note*" (annexed to the complaint as Exhibit "B"), under the terms of which Dragor agreed to pay Union "*on September 30, 1964*" the sum of $1,000,000 with interest at the rate of 5% per annum after January 1, 1964 until maturity (R. p. 3). It is further alleged that payment of said promissory note is past-due and delinquent, and that the plaintiff is entitled to the recovery of said amount (R. p. 4).

Service of Process

Service of process was purportedly effected by the service of the summons and complaint upon the Arizona Cor-

poration Commission on the 24th day of December, 1964 (R. pp. 13-14), allegedly under the provisions of Section 10-481 (a) (2) of the Arizona Corporation Statutes. That section provides in part that a foreign corporation, before transacting any business in Arizona, shall:

> "Appoint in writing under the hand of its president or other chief officer, attested by its secretary, a statutory agent in each county in this state in which the corporation will carry on business, and file with the corporation commission, in the form prescribed by the commission, an irrevocable consent to service of pleadings or process which shall become effective upon the revocation, annulment or voluntary withdrawal of the license to do business in this state, and which shall provide that actions arising out of or involving business done or transactions arising in this state may be commenced against the corporation in any court of competent jurisdiction within this state, by the service of pleadings or process upon the commission. The commission, upon being served, shall forward by registered mail a duplicate copy of the pleading or process, or both, to the last address of the corporation on file with the commission against which the pleading or process is directed."

The Defendant's Motion to Quash and Annul the Purported Service of Process As Invalid, Unconstitutional and Void.

By notice of motion (R. pp. 15-16), supported by the sworn affidavit of Ralph R. Weiser, its president (R. pp. 17-28), the appellant Dragor appeared specially "for the sole and only purpose of contesting the propriety and validity of the purported service of process upon it in this cause, and the jurisdiction of this Court over its person and the subject matter of this action . . ." (R. p. 15). It moved for an order quashing, vacating and annulling the

purported service of process as "invalid, unconstitutional and void" and dismissing the summons and complaint upon the ground that the Arizona District Court did not constitutionally obtain thereby jurisdiction over the person of Dragor Shipping Corporation or the subject matter of this action (R. pp. 15-16).

The facts set forth in the sworn affidavit of the appellant's president, none of which were controverted or denied, and all of which must be accepted as true upon this appeal, are as follows:

Prior to October 3, 1963, Union and Dragor were engaged in several extensive litigations which were then pending in the States of Arizona and California (R. pp. 21-22). In addition, there were actions pending by third parties against Union and/or Dragor in various courts, including the State of New York (R. pp. 21-22). Finally, Dragor had asserted certain claims against Union for contract adjustment arising from and out of a subcontract which had theretofore been executed by and between Union and a joint venture of Dragor and Idaho Maryland Industries, Inc., a California company, covering a portion of the construction of missile bases near Tucson, Arizona (R. p. 22).

On October 3, 1963, all of these litigations, claims, cross-claims and demands were fully, finally and completely settled and compromised by a settlement agreement between Union and Dragor which was embodied in two documents, one encaptioned "Agreement of Settlement" (annexed to the complaint as Exhibit "A"), and the second encaptioned "Covenant Not To Sue" (annexed to Dragor's moving papers as Exhibit "2") (R. pp. 22, 5-9, 26-27). These two documents collectively constituted the compromise and settlement agreement between the parties (R. p. 22). Each of these documents was simultaneously executed and delivered in the State of New York. By its terms, the "Agreement of Settlement" required Dragor's execution and de-

livery to Union of a non-negotiable promissory note in the sum of $1,000,000 payable upon certain designated conditions on September 30, 1964 (R. p. 7). Such a note was simultaneously executed and delivered by Dragor to Union in the State of New York (R. pp. 10-11, 22).

Upon the issuance, execution and delivery of these three documents in the State of New York on October 3, 1963, every right, claim, obligation, demand, liability or cause of action which had previously existed or had previously been asserted by either of the parties against the other "regardless of the nature or description thereof and whether or not now known", were *forever released, discharged, extinguished and at an end* (R. pp. 6, 22). From and after October 3, 1963, the *only* duties which Dragor owed to Union and the *only* duties which Union owed to Dragor were those reciprocal duties and obligations which had been carefully and explicitly set forth in the "Agreement of Settlement", "Covenant Not To Sue" and "Promissory Note", *each of which was issued, executed and delivered in the State of New York* (R. p. 22). By their terms, these documents created a contingent obligation on the part of Dragor which was not to become due and owing, under any circumstances, *until September 30, 1964* (R. pp. 10-11).

In the Court below, Dragor emphasized the immutable doctrine that a Federal District Court is a court of limited jurisdiction and that its jurisdiction must affirmatively appear upon the face of the complaint (R. p. 19). In this action, the complaint alleges only that "on October 3, 1963", the date of the "Agreement of Settlement" and promissory note, Dragor was licensed to do business and was doing business in the State of Arizona (R. p. 2, Complaint, par. 1). It does *not* allege that the Agreement of Settlement or promissory note were negotiated, issued, executed, delivered or breached in the State of Arizona (R. p. 20). It does *not* allege that the plaintiff's cause of action arose or accrued in the State of Arizona. Further, although the complaint alleges that Dragor breached the Agreement of Settlement

and promissory note by allegedly failing to pay the stipulated sum on September 30, 1964, *there is no allegation in the complaint that, on September 30, 1964, the date when the alleged cause of action arose, Dragor was qualified to do business or was in fact transacting any business whatsoever in the State of Arizona* (R. p. 20).

On the contrary, as incontrovertibly appears from the moving affidavit, Dragor was not licensed to do business in the State of Arizona on September 30, 1964, and was not in fact transacting any business whatsoever in that state on that day, or for many months prior thereto, or at any time thereafter (R. p. 20). As appears from the formal certificate of the Arizona Corporation Commission (annexed to Dragor's motion papers in the Court below as Exhibit 1), Dragor had formally withdrawn from the State of Arizona on *April 30, 1964,* approximately five months before the plaintiff's cause of action accrued (R. pp. 20, 25). Simultaneously, the authority of its statutory agent to accept service on its behalf was duly terminated (R. p. 20). The appellant's president swore, and it was nowhere controverted, that the appellant had not engaged in the transaction of any business of any kind in the State of Arizona for many months prior to its formal withdrawal from that state on April 30, 1964, or at any time thereafter (R. p. 20).

Consequently, it is incontrovertible that Dragor was not engaged in the transaction of any business or qualified to transact any business in the State of Arizona, either on September 30, 1964, when Union's alleged cause of action arose upon an instrument executed, delivered and effective in the State of New York, in a transaction consummated in the State of New York, or on December 24, 1964, when service of process was effected upon the Arizona Corporation Commission (R. p. 20).

The causes of action set forth in the plaintiff's complaint are, upon their face, based upon the plaintiff's affirmance of the New York settlement agreement of October 3, 1963

and the New York promissory note executed and delivered by Dragor thereunder (R. p. 23). By this action, Union is seeking to enforce in Arizona a duty created solely and only by documents executed, delivered and effective in the State of New York, and not a duty created by any other fact, transaction or circumstance occurring at any other time or place (R. p. 23). Similarly, Dragor is claiming the benefits of that settlement agreement, benefits of which it has allegedly been deprived by Union's breach of the specific obligations which it had undertaken under these very settlement documents (R. p. 23).

In summary, it conclusively appears from the sworn affidavit submitted in support of Dragor's motion to quash the service of process that:

(1) Neither Union nor Dragor is an Arizona corporation. Neither has ever had its principal place of business in the State of Arizona.

(2) On October 3, 1963, all rights, claims, obligations, liabilities or causes of action which had theretofore existed between Union and Dragor, "regardless of the nature or description thereof, and whether or not now known", were forever released, extinguished and at an end.

(3) On and after October 3, 1963, the *only* duties which Union owed to Dragor, and the *only* duties which Dragor owed to Union, were the duties created by the settlement documents and promissory note issued, executed and delivered in the State of New York.

(4) On April 30, 1964, Dragor formally withdrew from the State of Arizona and terminated the authority of its statutory agent in Arizona to accept service on its behalf. It has not engaged in the transaction of any business of any kind in the State of Arizona since that date.

(5) On September 30, 1964, the date when Dragor's promissory note allegedly became due and Union's cause of action allegedly accrued, Dragor was neither qualified to do business in the State of Arizona nor was it engaged in the transaction of any business in that state.

(6) The causes of action set forth in Union's complaint, based upon and arising out of Dragor's alleged breach of documents and instruments executed and delivered in the State of New York, are not causes of action which come within the purview of Section 10-481 (a) (2) of the Arizona Corporation Statutes or any other Arizona state statute which purports to authorize the Arizona Courts to exercise an *in personam* jurisdiction over non-residents upon causes of action arising in Arizona.

Union's Opposition to Dragor's Motion

The only statement under oath submitted by Union in opposition to Dragor's motion to quash was an affidavit of Thomas C. McConnell, one of Union's counsel (R. pp. 62-63). In that affidavit, Mr. McConnell did not deny the statements of fact contained in the moving affidavit of Dragor's president. He merely argued that the formal certificate issued by the Arizona Corporation Commission certifying to Dragor's withdrawal from the State of Arizona on April 30, 1964 contained the provision "and thereupon said corporation ceased to exist, except as to creditors" (R. p. 63).

Mr. McConnell contended that, "at the time of said attempted withdrawal by Ward (Dragor), the plaintiff Union was a creditor of Ward (Dragor) on an obligation created by acts performed in Arizona at a time when Ward (Dragor) was qualified to do business in Arizona and therefore by the very terms of the affidavit Ward (Dragor) did not terminate its authority to do business in Arizona as against this plaintiff".

In short, Union claimed in the Court below that, on April 30, 1964, the date when Dragor formally withdrew from Arizona and terminated the authority of its statutory agent, Union was an *Arizona creditor* of Dragor "on an obligation *created by acts performed in Arizona*", although on that day, Dragor's *only* obligation to Union was its contingent liability upon a *New York* promissory note issued and payable under a *New York* settlement agreement executed and delivered six months before. This specious legal argument, founded upon the factually insupportable assertion that Union was an Arizona creditor of Dragor upon an Arizona obligation when it withdrew from Arizona on April 30, 1964, was sustained by the District Court in overruling Dragor's motion to quash and annul the service of process herein.

The Decisions of the Arizona District Court

Dragor's motion to annul and vacate the service of process was denied by the District Court on February 2, 1965 without opinion (R. p. 182). Subsequently, the District Court refused, likewise without opinion, to certify a question to this Court for immediate hearing under 28 U.S.C., Section 1292, Subsection (b) (R. pp. 64-67, 182). An attempt to procure a review by this Court of the constitutional issues presented herein by an application for leave to file a petition for a writ of prohibition was denied on March 22, 1965 (R. p. 169).

Thereafter, Dragor invoked every remedy available to it to avoid the interposition of its answer and compulsory counterclaim because of its fear that it might thereby involuntarily waive its special appearance (R. pp. 104-105; 89-90). Union's argument that Dragor would not waive its special appearance by the service of such a pleading was upheld by the District Court. Subsequently, having exhausted all its remedies, Dragor filed an answer containing a compulsory counterclaim. Union thereupon moved (1)

to dismiss the compulsory counterclaim as insufficient in law (R. p. 117) and (2) for a judgment on the pleadings (R. p. 110). Although the District Court denied Union's motion to strike the compulsory counterclaim, it granted Union's motion for judgment on the pleadings on plaintiff's complaint (R. 184), even before the pleadings were closed by the filing of Union's reply to the counterclaim (R. pp. 141-142, 154-156, 184). The judgment was made and entered on June 1, 1965 (R. p. 151). It is from that judgment, and the order denying appellant's motion to quash the service of process, that this appeal has been taken (R. pp. 163-164).

Specification of Errors

I

The District Court erred in denying the appellant's motion to quash, vacate and annual the service of process upon the Arizona Corporation Commission and dismiss the plaintiff's complaint upon the ground that the Court did not possess an *in personam* jurisdiction over the appellant, a non-resident Delaware corporation, neither qualified to do business nor doing business in the State of Arizona, upon a cause of action arising in the State of New York to enforce an obligation created solely by documents executed, delivered and allegedly breached in that state.

II

The District Court erred in attempting to assume jurisdiction over the appellant, a non-resident Delaware corporation, after it had formally withdrawn from the State of Arizona, upon a cause of action arising in the State of New York after such withdrawal.

III

The District Court erred in holding that, on April 30, 1964, when the appellant formerly withdrew from the State of Arizona and terminated the authority of its

statutory agent in that state, the appellee was an Arizona creditor of the appellant upon an obligation created in Arizona. The obligation sought to be enforced in this action by the plaintiff was solely an obligation created by a settlement agreement and promissory note executed and delivered by and between the parties in the State of New York, which became due on September 30, 1964, when the appellant was neither qualified to do business nor doing business in the State of Arizona.

ARGUMENT

POINT I

The Arizona District Court's Assumption of Jurisdiction Over the Person of Dragor and Thereby Over the Subject Matter of This Action Is Unconstitutional and Void Under the Decisions of the United States Supreme Court Culminating in *Hanson* v. *Denckla*, 357 U. S. 235.

It appears, without contradiction, that the appellant Dragor has not been authorized or qualified to do business in the State of Arizona since April 30, 1964. It has not engaged, since that date, and for many months prior thereto, or at any time thereafter, in the transaction of any business whatsoever in the State of Arizona. It was neither qualified to do business, nor engaged in the transaction of any business in that state, on September 30, 1964, the date when Union's cause of action against Ward allegedly arose.

It further appears, equally without contradiction, that the respondent Union's cause of action is based upon Dragor's alleged breach of a settlement agreement embodied in three documents encaptioned "Agreement of Settlement", "Covenant Not to Sue" and "Promissory Note", all of which were executed, issued and delivered by and between the parties in the State of New York on October 3, 1963. By its very terms, the settlement agreement fully, completely,

finally and irrevocably discharged each and every pre-existing right, claim, obligation, demand, liability or cause of action, "regardless of the nature or description thereof and whether or not now known". From and after October 3, 1963, the date when this transaction was duly consummated in the State of New York, the only duties owed by these parties to each other were their reciprocal duties and obligations created by the execution of the Agreement of Settlement, Covenant Not to Sue and Promissory Note in the State of New York, and not in the State of Arizona.

A.

The New York settlement between Union and Dragor on October 3, 1963 extinguished forever any and every demand, claim and liability, wherever the same had arisen, which had theretofore been asserted between the parties. The only duties and obligations thereafter arising and the only duties and obligations enforceable in this action were the duties and obligations created by the New York settlement and New York promissory note under New York law.

A settlement and compromise constitutes, at common law, "*a new and superior contract superseding and extinguishing the contract or contracts upon which the original action between the parties was based, and the action itself.* It relates to matters of differences and controversies, other than, as well as, those involved in the original action. It concerns all the claims and grievances of the plaintiff against the defendant and of the defendant against the plaintiff. Each party enters into new agreements and assumes new obligations". (*Moers* v. *Moers*, 229 N. Y. 294, at 300).

A comprehensive description of the legal import of the settlement agreement under the laws of the State of New York—the locus of the instruments—was formulated by the New York Court of Appeals in *Yonkers Fur Dressing Co.* v. *Royal Insurance Co.*, 247 N. Y. 435, in the following language at pages 444, 446:

"The settlement of the original controversies involved in these actions resulted in a new agreement to the effect 'that the above entitled litigation is settled and terminated, * * * the insurance companies in interest having agreed to pay the sum of $92,500 in full settlement of all claims.' This is not a mere arrangement between counsel made during the pendency of the case from which a party might be relieved when both parties could be restored substantially to their former position in court and when it would be inequitable to hold the parties to it. (Magnolia Metal Co. v. Pound, 60 App. Div. 318; Hallow v. Hallow, 200 App. Div. 642.) It is the settlement and termination of the litigations, marking a fresh start by the plaintiff from a new coign of vantage. The compromise was wholly foreign and extrinsic to the litigation and to any action by the court. * * * *When the cases were marked 'settled and discontinued' in open court by the parties, it was as if they had never been begun.*

A contract of settlement, if valid in itself, is final and is to be sustained by the court without regard to the validity of the original claim. (Smith v. Glens Falls Ins. Co., 62 N. Y. 85; Sears v. Grand Lodge A.O.U.W., 163 N. Y. 374.)

* * * The agreement of settlement was, under these circumstances, entered into by defendants, not lightly, inadvertently, inadvisedly or improvidently, but in order to make the best terms possible with the plaintiff. The hope of gaining was balanced against the risk of losing. There was an exchange of equivalents, irrevocable except for fraud, a settlement of a controversy presumably honest. *The old causes of action were terminated. A new liability was substituted therefor. The nature of the new cause of action we need not define. Enough to say that it superseded the old.*" (Italics ours)

The foregoing rules of law have been universally applied. In *Wilson* v. *Bogert*, 81 Idaho 535, 347 P. (2d) 341, 345, the Supreme Court of Idaho formulated the applicable principles as follows, citing California decisions in support thereof:

> "An agreement of compromise and settlement is a merger and bar of all pre-existing claims which the parties intended to settle thereby. Moran v. Copeman, supra; Shriver v. Kuchel, 113 Cal. App. 2d 421, 248 P. 2d 35; 15 C.J.S. Compromise and Settlement § 24, p. 739. *Such prior claims are thereby superseded and extinguished.* The compromise agreement becomes *the sole source and measure of the rights of the parties* involved in the previously existing controversy. The existence of a valid agreement of compromise and settlement is a complete defense to an action based upon the original claim. Bruce v. Oberbillig, 46 Idaho 387, 268 P. 35; Shriver v. Kuchel, supra; Argonaut Ins. Exch. v. Industrial Acc. Commission, 49 Cal. 2d 706, 321 P. 2d 460; 11 Am. Jur., Compromise and Settlement, § 36 p. 284." (Italics ours)

In *Jones* v. *Noble*, 3 Cal. App. 2d 316, 39 P. (2d) 486, 489, the District Court of Appeals of California ruled as follows:

> "It is well understood that the making of a valid compromise agreement to settle claims for money which are stated in a cause of action in a pending suit in court *extinguishes the cause of action;* the compromise agreement becoming successor to or substitute therefor. Armstrong v. Sacramento Valley R. Co., 179 Cal. 648, 178 P. 516." (Italics ours)

The Arizona rule is precisely the same. In *Pacheco* v. *Delgardo*, 46 Ariz. 401; 52 P. (2d) 479, 480, the Arizona Court declared:

> "It is unquestioned that where a plaintiff has a cause of action against a defendant, and the same is

> compromised and satisfied in a proper and legal manner, the right of action is entirely *extinguished,* and no suit may be brought thereon''. (Italics ours)

Again, in *Cano* v. *Arizona Frozen Products Co.,* 38 Ariz. 404, 408, 300 Pac. 953, the Court held:

> ''If A, who claims B owes him $2000, offers to accept a note of $1000 in full settlement of the claim and B delivers the note, if it is not paid when due, the suit must be on the note, and not on the original claim.''

If, as the Courts throughout the land, including New York and Arizona, have universally held, an agreement of settlement completely extinguishes an existing claim and disposes of a previously instituted action or actions ''as if they had never been begun'' (*Yonkers Fur Dressing Co.* v. *Royal Insurance Co., supra,* at p. 444), and if, by virtue of the agreement of compromise and settlement, ''a new liability was substituted'' for any claims previously existing, the new having ''superseded the old'', then it is plain that the situs of the actions thereby superseded, extinguished and at an end ''as if they *had never been begun*'', cannot possibly constitute a constitutional basis for the assumption of jurisdiction over a non-resident upon the superseding obligation by any state other than the state where that new obligation was created.

In the Court below, the respondent argued, in its memorandum of points and authorities that: ''The fact that the settlement agreement and promissory note were physically signed in New York is not material in determining whether the claim sued upon arises out of defendant's conduct in this state. At most, the settlement agreement and note evidence defendant's obligation; the documents themselves do not constitute payment of the obligation which arose by reason of Dragor's default in performance of the contract in Arizona'' (R. pp. 54-55).

The argument is spurious. It is predicated upon a total misstatement of the import of the promissory note and agreement of settlement which constitute the sole and only basis for the plaintiff's cause of action. Implicit in Union's argument that the plaintiffs cause of action upon the New York settlement agreement and New York note, the only cause of action alleged in the complaint, "arose" by reason of "Dragor's default in performance of the contract in Arizona" is the totally erroneous hypothesis that the New York settlement agreement constitutes somehow, in some way, an admission by Dragor of a "default" in Arizona. It hardly requires any extensive or exhaustive enumeration of authorities to establish the proposition that the settlement of an action is never deemed evidence of a liability, nor does it constitute an admission of such liability. It is simple hornbook law that "settlements are considered *as merely showing a desire to avoid or to seek a surcease of litigation on the part of the defendant*—a policy favored by the law". (*Quillen* v. *Board of Education*, 203 Misc. 323 (N.Y.), citing 4 Wigmore on Evidence [3d ed.], §§ 1061-1062.) "It has always been the policy of the law to favor compromise and settlement." (*Dansby* v. *Buck*, 92 Ariz. 1, 8; 373 P. (2nd) 1.)

B.

Having formally withdrawn from the State of Arizona on April 30, 1964, and terminated the authority of its Arizona statutory agent on that day, Dragor could not, eight months thereafter, be subjected to the jurisdiction of the Arizona District Court upon a cause of action arising in the State of New York under settlement documents executed and delivered in that state.

The cause of action presented by the instant complaint, over which the District Court purported to assume jurisdiction *in personam* over this defendant, is *a cause of action arising in the State of New York on September 30, 1964 upon settlement documents executed and delivered in the State of New York*, having no constitutional relationship whatsoever to the claims extinguished by those settlement

documents on October 3, 1963. Any matter, fact or circumstance occurring *prior* to the execution of the settlement documents in the State of New York, which alone constitute the source of the parties' mutual liabilities and the Court's judicial power to determine the same, is totally irrelevent, under the decisions of the United States Supreme Court, in determining the constitutional power of a state to subject non-residents to its process.

No federal Circuit Court in the United States has engaged in a more exhaustive and penetrating critique of the constitutional basis for the exercise or disavowal of *in personam* jurisdiction over non-residents than this Court. Its recent decisions in this area constitute a comprehensive analysis of the latest United States Supreme Court decisions upon the subject and a clear formulation of the operative factors which must exist before the jurisdiction of a state or federal court may properly and constitutionally be invoked over the persons of those who reside beyond its territorial borders.

In *L. D. Reeder Contractors of Arizona* v. *Higgins Industries,* 265 Fed. (2d) 768, this Court was called upon to examine the three most recent United States Supreme Court decisions in the field of jurisdiction *in personam*—*International Shoe Co.* v. *State of Washington,* 326 U. S. 310; *McGee* v. *International Life Ins. Co.,* 355 U. S. 220; and *Hanson* v. *Denckla,* 357 U. S. 235—and formulate therefrom the constitutional principles applicable to the efforts of a state to subject non-residents beyond its borders to the mandate of its courts.

This Court commenced its opinion with a concise statement of fundamental law. It declared at p. 770:

> "'Jurisdiction' in law is not a simple matter. To obtain a valid judgment, the party seeking it must (a) proceed in a competent court; (b) give his opponent reasonable notice of the litigation and grant

him a reasonable opportunity to be heard; and (c) establish 'judicial jurisdiction' over the defendant involved.

Obviously a lack of competence of the court to hear the matter will prevent the entry of a valid judgment. In statutory courts, of which the federal court is one, compliance with the statutory jurisdictional requirements, such as diversity and amount in controversy, must be alleged and proven. McNutt v. General Motors Acceptance Corp., 1936, 298 U. S. 178, 189, 56 S. Ct. 780, 80 L. Ed. 1135; Chicago Burlington & Quincy R. Co. v. Willard, 1911, 220 U. S. 413, 419-421, 31 S. Ct. 460, 55 L. Ed. 521."

It thereupon reviewed with great care the three United States Supreme Court decisions noted above and drew the following conclusions therefrom (p. 773):

"We note that the acts which have a substantial connection with the state are acts which also have a substantial and, indeed, *direct connection with the cause of action sued upon;* i.e., *the cause of action arises by reason of acts so connected.* When this double substantial connection exists, then, in view of the broad language of McGee v. International Life Ins. Co., supra, a single act or transaction may be the basis for jurisdiction over a nonresident defendant.

This broad language of McGee v. International Life Ins. Co., supra, must likewise be considered in view of the Supreme Court's latest pronouncement on the subject in Hanson v. Denckla, 1958, 357 U. S. 235, 78 S. Ct. 1228, 2 L. Ed. 2d 1283. There the Florida probate court attempted to exercise personal jurisdiction over a Delaware trustee by means of constructive service by publication authorized by Florida statute. The trust had been created in

Delaware of a corpus physically located therein by a resident of that state who had later become domiciled in Florida. There had been correspondence by mail between settlor and trustee, and income paid to the settlor in Florida. The settlor also exercised a power of appointment over the trust while living in Florida.

In Hanson v. Denckla, supra, Mr. Chief Justice Warren's opinion *denied jurisdiction on these facts,* finding that the 'minimal contacts' required for jurisdiction did not exist, for:

> 'The unilateral activity of those who claim some relationship with a nonresident defendant cannot satisfy the requirement of contact with the forum State. The application of that rule will vary with the quality and nature of the defendant's activity, but it is essential in each case that there be some act by which the defendant purposefully avails itself of the privilege of conducting activities within the forum State, thus invoking the benefits and protections of its laws.' 357 U. S. 235, 253, 78 S. Ct. 1228, 1239.

Thus there is established as essential some act by which the defendant 'purposefully' seeks the privilege of conducting activities within the forum state and obtaining the benefit and protection of its laws. *This essential act of the defendant must give rise to or result in a cause of action within that forum state.''*

It adopted, with approval, the following exposition of existing law (p. 773, footnote 10):

> ''Everyone concedes, of course, that jurisdiction, grounded upon a single act, *must be limited to causes of action arising out of that act.* To subject the nonresident individual, or corporation, to a general in personam jurisdiction because of such limited contact would be unfair and unreasonable, no matter how

adequate the notice. Sobeloff, Jurisdiction of State Courts Over Non-Residents in Our Federal System, 43 Cornell L. Q. 196, 208 (1957)."

In concluding that Higgins could not be subjected to the jurisdiction of the California courts, this Court emphasized the following considerations, each of which is directly applicable to the case at bar (pp. 775 et seq.):

"It is difficult to see how any facts showing defendant's activities within the forum state of California gave rise to any of the causes of action contained in the complaint. The shipment went to Reeder in Arizona. Any specific activity in California by Higgins' agents, subsequent to the contract, related only to time of shipment.

* * * We think a consideration of these factors leads us to the inescapable conclusion that as to appellee Higgins the 'estimate of inconveniences' weighs heavily in its favor. We need not point out again the slim thread of facts which connects Higgins with the forum state which the appellant has chosen. We do feel that it is significant that this is not a case where the state of California 'has a manifest interest in providing effective means of redress for its residents', to use the words of Mr. Justice Black in the McGee case. Reeder, the plaintiff here, is not a California corporation but an Arizona corporation, doing business in Arizona by use of the very goods which are the subject of this suit. We note, also, that a very recent federal court case in New York has taken this view under a statute similar to that in question in the McGee case. We think it a sound and reasonable view under the facts of this and similar cases.

* * * We recognize the courts generally have come a long way from Pennoyer v. Neff, supra, but if they

> are to come as far as appellant would urge us here, that final step would be a first one, and must come from a higher court." (Italics ours)

This Court's decision in the foregoing case was followed by its decision in *Kourkene* v. *American BBR, Inc.*, 313 Fed. (2d) 769, wherein it completely reaffirmed the principles which it had previously formulated. In quashing service upon a Pennsylvania corporation, purportedly effected by serving the Secretary of State of California, this Court ruled as follows (p. 773):

> "Weighing the facts of this case against these tests, we hold that the district court did not err in granting appellee's motion to quash the service made upon it through the Secretary of State. As noted earlier, appellee's principal place of business is in Philadelphia, Pennsylvania. There is no evidence that appellee has ever qualified to do business in this state; has ever maintained any office, records, agents, employees, distributors or representatives in California; has ever manufactured or produced any product or commodity for sale within California; or ever shipped or sold any such product or commodity within California. At the most, the evidence reveals a few isolated activities on the part of appellee in California. *Since it is clear that the appellant's cause of action did not arise out of or result from any of these activities,* we agree with the district court that 'the record is devoid of any evidence which would warrant the conclusion that American BBR is doing business in California.' " (Italics ours)

Under the United States Supreme Court decisions in *International Shoe Co.* v. *State of Washington, supra, McGee* v. *International Life Ins. Co., supra,* and particularly, *Hanson* v. *Denckla, supra,* as well as this Court's decisions

in the *L. D. Reeder* and *Kourkene* cases, *supra*, it is clear beyond the possibility of controversy or dispute that the act or transaction committed within the forum state which is claimed to constitute the constitutional nexus for jurisdiction over the non-resident *must be the very act or transaction creating the cause of action within the forum state which is sought to be asserted against such non-resident.* In the language of this Court in the *L. D. Reeder* case, *supra*, such act "*must give rise to or result in a cause of action within that forum state*" (p. 773).

The validity of these principles was strikingly confirmed by the District Court in its recent decision in *Executive Properties, Inc.* v. *Sherman*, 223 Fed. Supp. 1011 (Nov., 1963). In that case, the plaintiff, an Arizona corporation, was employed by the non-resident defendants, pursuant to a written contract delivered in Arizona, to procure a purchaser for real property located in Arizona. The plaintiff alleged that it procured such a purchaser but that the defendants refused to perform. Since the defendants were residents of Illinois, service was effected by registered mail under Rule (4) (e) (2) of the Arizona Rules of Civil Procedure. The defendants thereupon moved to dismiss the cause for lack of jurisdiction over the person of the defendants.

In affirming jurisdiction, District Judge East underscored the fact that the plaintiff's cause of action *arose in the State of Arizona* as a result of the acts committed by the defendants *within that state.* He particularly emphasized the United States Supreme Court's decision in *Hanson* v. *Denckla*, 357 U. S. 235 with its stress upon the *fact that the cause of action arose "out of an act done or transaction consummated in the forum State."* Judge East ruled as follows (pp. 1015 *et seq.*):

> "Hanson acknowledged the International Shoe doctrine of 'minimum contacts' but failed 'to find

such contacts in the circumstances of this case * * *' as 'the record discloses no solicitation of business in that State either in person or by mail.' And, further '* * * [*t*]*he cause of action in this case is not one that arises out of an act done or transaction consummated in the forum State.*' [Italics supplied.] 357 U. S. 251, 78 S. Ct. 1238, 2 L. Ed. 2d 1283.

This language from Hanson lends great significance to the language of Rule 4, which subjects a person who '* * * has caused an event to occur in this state out of which * * * the [cause of action] arose * * *' to *in personam* jurisdiction.''

* * *

''As for the case before us, the following in-Arizona contacts appear on the record:

1) Plaintiff, one of the contracting parties, is and was at all pertinent times an Arizona corporation;

2) The nonresident defendants own real estate situate in Arizona, the subject matter of the contracts, and over which the claimed brokerage commission claim held by plaintiff arose;

3) The entire unilateral performance by plaintiff of the contract out of which the claim (cause of action of plaintiff) for a brokerage commission is based was wholly had within Arizona; and

4) The defendants caused their executed documents to be sent into Arizona to be acted upon in Arizona, and one of the defendant trustees was actually present within Arizona at the time of executing escrow instructions with reference to the exchange agreement.

It is from these events which the defendants 'caused * * * to occur in (Arizona), out of which

> (plaintiff's) claim * * * which is the subject of the complaint arose, * * *' Manifestly, the defendants had more than the requisite 'minimum contacts' with Arizona under the formula of International Shoe, supra, in order to affix in personam jurisdiction, and, furthermore:
>
> 'It is sufficient for purposes of due process that the suit was based on a contract which had substantial connection with that State.' McGee, supra, 335 U. S. p. 223, 78 S. Ct. p. 201, 2 L. Ed. 2d 223." (Italics ours)

Distinguished commentators upon the meaning, purport and scope of the United States Supreme Court's decisions in the *International Shoe Co.*, *McGee* and *Hanson* cases, *supra*, have all supported the views herein expressed. Thus, Judge Sobeloff, whose article in 43 Cornell Law Quarterly 196, entitled "Jurisdiction of State Courts Over Non-Residents in Our Federal System" was cited with approval by this Court in *L. D. Reeder*, *supra*, at page 773, referred to the decision of his own Circuit Court in *Erlanger Mills, Inc.* v. *Cohoes Fibre Mills, Inc.*, 239 F. (2d) 502 (4th Circ., 1956). In that case, Erlanger, a North Carolina corporation, sent its representative to New York to purchase a quantity of synthetic yarn. The defendant Cohoes, a New York corporation, sold and shipped the goods to Erlanger in North Carolina, f.o.b., New York. Erlanger later brought suit in the North Carolina State Court to recover for alleged defects in the goods. Jurisdiction was sought under a North Carolina Statute which provided that foreign corporations, though not doing business in North Carolina, were subject to suits or claims arising from a sale of goods, *no matter where consummated*, if the goods were shipped into North Carolina and were used in that state. Upon removal of the case to the District Court, service was quashed and the decision of the District Court affirmed on appeal. In commenting upon this decision under the doctrines formulated by the United States Supreme Court, Judge Sobeloff declared in his article (*supra*, at p. 208):

> "Everyone concedes, of course, that jurisdiction, grounded upon a single act, must be limited to causes of action arising out of that act. To subject the non-resident individual, or corporation, to a general in personam jurisdiction because of such limited contact would be unfair and unreasonable, no matter how adequate the notice."

A study published in the Georgetown Law Journal, Vol. 47, p. 326, encaptioned "Jurisdiction Over Non-Resident Corporations Based On A Single Act: A New Sole for International Shoe" cited by this Court with approval in the *L. D. Reeder* decision, *supra,* pp. 773-774, footnote 12, formulated as Rule 2 of the "three rules which can be drawn from a combined reading of *International Shoe, McGee* and *Hanson,* against which all future litigation of a like nature may be tested" the fundamental principle that *"the cause of action must be one which arises out of or results from the activities of the defendant within the forum."*

That the State of Arizona, prior to the execution and delivery of the settlement agreement on October 3, 1963, may constitute the locus of some part of the historical background preceding the creation in New York under New York law of the rights and responsibilities of the parties to the settlement agreement, cannot possibly constitute any support whatsoever for the District Court's assumption of jurisdiction in this matter. The precise issue was presented to the New York Courts in the recent case of *Boas and Associates* v. *Vernier,* 22 App. Div. (2d) 561, decided by the Appellate Division of the First Department on March 23, 1965. The plaintiff sued to recover commissions as a business broker and industrial consultant in introducing the defendant to certain French underwriters. Initially, the plaintiff was employed under a written agreement "negotiated and executed in New York by defendant as General Manager of the French corporation". Subsequently, the written agreement of employment was *superseded* by an

oral agreement for the plaintiff's services under which the plaintiff claimed a commission. The oral agreement was not negotiated or concluded by the parties in New York.

Jurisdiction was sought to be sustained upon the ground that the prior written agreement had been executed in New York and that such contract was sufficient to sustain the jurisdiction of the Court over the defendant. In dismissing the action upon the ground that the Court lacked jurisdiction over the person of the defendant, the New York Court ruled as follows, in language directly applicable to the instant case:

> "The complaint seeks the agreed commissions earned by plaintiff as broker and consultant in introducing defendant to certain French underwriters and rendering other services leading to the merger of a French corporation of which defendant was principal stockholder and chief executive officer into a new French corporation. In the absence of any showing that the oral agreement with defendant was negotiated or concluded by defendant in New York, it cannot be said that the causes of action arose from an act of defendant in the transaction of business within the State (CPLR 302, subd. [a], par. 1). *The fact that a prior written agreement was historically necessary to the inception of the subsequent oral agreement does not alone, for purposes of the jurisdiction statute, support personal jurisdiction.*" (Italics ours)

Of decisive importance in the determination of the issues presented by the instant case is the ruling of the New York Court in the cited decision that "the fact that a prior written agreement was *historically necessary to the inception of the subsequent oral agreement* does not alone, for purposes of the jurisdiction statute, support personal jurisdiction". Similarly, in this case, the fact that certain reciprocal claims had arisen prior to the execution of the settlement agree-

ment, or that certain litigations were pending prior to the consummation of that settlement agreement and were "historically necessary to the inception" thereof, does not and cannot constitutionally support the assertion of jurisdiction by the State of Arizona on behalf of a non-Arizona citizen or domiciliary over a non-resident defendant upon a cause of action created by documents executed in the State of New York with which cause of action the State of Arizona has absolutely no connection whatsoever.

The vice of the attempted assertion by the District Court of jurisdiction over the appellant is dramatically illustrated by what has occurred in the instant case. The only consideration which induced this defendant to settle and compromise the various suits and claims in which it was involved prior to October 3, 1963 was the enormous and imminently ruinous cost of being compelled to engage in extensive litigations in California, Arizona and other states many thousands of miles from its principal office (R. pp. 82-83). It sought to purchase its peace, permanently, and remove itself from these various forums in which it was incurring an economic burden which it could no longer bear by executing, in the State of New York, an agreement of settlement and compromise which terminated, for all time, any contact whatsoever with the State of Arizona. It sought, by these means and by the contemplated expenditure of an enormous sum of money, to dispose of matters for which it had denied any liability whatsoever, by defining and limiting its obligation, as well as the obligations of the other party to the controversies between them, to the duties and responsibilities created by the settlement agreement executed and delivered in New York. The alleged breach of that agreement by either Union or Dragor created litigable issues which possess no constitutional nexus whatsoever with any other jurisdiction but the State of New York.

The settlement which both parties are seeking to affirm, each charging the other with its breach, disposed forever of any possible contact with the State of Arizona which may

have existed prior to the execution thereof. Dragor has nevertheless been subjected by the ruling of the District Court below to a litigation in Arizona upon the very contract by which, for an inordinate price, it had sought to disassociate itself from a state where continued litigation threatened it with financial ruin (R. p. 83).

CONCLUSION

The action of the District Court is constitutionally invalid and void. It is respectfully submitted that the judgment appealed from be reversed, the defendant's motion to quash the service of process and dismiss the complaint because the Court lacked jurisdiction of the subject matter of this action and the person of this defendant be granted and all proceedings heretofore had in the District Court of Arizona be annulled.

Respectfully submitted

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Certificate of Compliance

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOSEPH LOTTERMAN
Attorney

No. 20416

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

DRAGOR SHIPPING CORPORATION,
formerly WARD INDUSTRIES CORPORATION,

Appellant,

vs.

UNION TANK CAR COMPANY, a corporation,

Appellee.

BRIEF OF APPELLEE

UNION TANK CAR COMPANY

Upon Appeal from the District Court of the United States
for the District of Arizona

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BRIEF OF APPELLEE

UNION TANK CAR COMPANY

Statement of Facts

The Statement of the Case in Appellant's brief omits important facts and is so disjointed and misleading that it is impossible to properly present the issues in this case without completely restating the facts.

The instant case grew out of the financial debacle created when the Appellant Dragor Shipping Corporation (formerly Ward Industries Corporation) and its joint venturer Idaho-Maryland Industries, Inc., defaulted in performance of their $7,800,000 second-tier subcontract with Union, the Appellee, on the Davis-Monthan Missile Launch project near Tucson, Arizona (R. 40).

The facts upon which the court below found that it had personal jurisdiction over the appellant were

established by affidavits, exhibits and court records in this and related judicial proceedings of which the District Court could take judicial notice (R. 40). These facts are summarized below:

Dragor, a Delaware corporation, obtained a certificate of authority from the Arizona Corporation Commission to transact business within the State of Arizona on July 29, 1947 (R. 40). For a period of 17 years it maintained that license in full force and effect and did not seek to withdraw from Arizona until six months after executing the promissory note upon which this suit is brought. At all times material to this case, Dragor had designated the C. T. Corporation at Phoenix, Arizona (R. 41) as its statutory agent upon whom notices and process might be served as provided for by Arizona Revised Statutes §10-481.

Dragor, then known as Ward Industries Corporation, while licensed to transact business in Arizona, formed a joint venture with Idaho-Maryland Industries, Inc., (IMI) a California construction company, which joint venture, in the summer of 1961, entered into a second-tier subcontract with Union for the performance of work at the U. S. Missile Launch Facilities, near Tucson, Arizona (R. 5). The agreed price to be paid by Union to the said joint-venture for performance of the work specified under the subcontract was $7,791,000 (R. 41).

In December, 1961, IMI, the managing partner of the joint venture, could not pay labor and material creditors in connection with performance of the aforesaid joint-venture subcontract work. On February 2, 1962, IMI filed a petition under Chapter XI of the Federal Bankruptcy Act (R. 5) in the United States District Court for the Southern District of California,

Central Division (No. 137,024-W.B.). After the filing of those proceedings, Dragor and the joint venture failed to complete the subcontract with Appellee Union (R. 5), and Union was forced to complete the same at a cost of approximately $9,000,000 in excess of the subcontract price (R. 41).

In May, 1962, Union filed a diversity action in the United States District Court for the Northern District of Illinois, Eastern Division, against Dragor to recover the losses it sustained by reason of the aforesaid default of the joint-venture. Dragor entered a general appearance in the action and moved to transfer it to the United States District Court for the District of Arizona pursuant to 28 U.S.C., §1404(a), (R. 43), on the ground that all matters involved in the action originated in the State of Arizona which was the appropriate forum for conducting the litigation (R. 41).

It appears from the records of the court below, of which that court and this Court of Appeals have judicial notice, that Dragor's then president Gammeltoft stated under oath in support of Dragor's motion to transfer, in part as follows (R. 43):

> "It is clear that Illinois has no connection with this litigation. The project, the witnesses and the documents are in Arizona. The contracts in suit were signed by the defendant in New York. The defendant carries on no business in the State of Illinois and does not maintain an office force. This court does not and cannot obtain jurisdiction over IMI, without which there will be mere circuity of litigation. *In this connection all three parties are subject to the jurisdiction of the Arizona District Court in Tucson, Arizona* * * *." (Emphasis supplied).

On the strength of this affidavit, the case was thereupon transferred to the United States District

Court for the District of Arizona at Tucson, Arizona (Union Tank Car Company v. Ward Industries Corporation, Civ. 1482-Tuc.) (R. 43). While the file in Civ. 1482 was en route to Arizona, Dragor instituted a separate and independent action (R. 42) against Union in the same court,[1] seeking rescission of the subcontract with Union and money damages (*Ward Industries Corporation v. Union Tank Car Company,* Civ. 1478-Tuc.)

Extensive pretrial proceedings were subsequently conducted by the parties before the Honorable James A. Walsh, Judge of the court below. On October 3, 1963, just prior to the trial date of the above actions, the parties entered into an Agreement of Settlement under the terms of which Dragor agreed to pay Union the sum of $1,000,000, to be evidenced by a promissory note due September 30, 1964, with interest at the rate of 5% per annum to maturity and 7% thereafter (R. 42). The agreement provided for the exchange of releases of their respective claims in the Tucson litigation and was to be performed in part at Tucson, Arizona, by appearances before the District Court in Tucson to dismiss with prejudice the respective actions then pending in the Tucson District Court. The delivery of the aforesaid promissory note for $1,000,000 was conditioned upon the dismissal by the parties of said suits and upon execution of the settlement agreement (R. 5, 8). Thereafter the parties, by their respective counsel, did appear before Judge Walsh and obtained a dismissal with prejudice of both proceedings.

At the time these acts were performed in Arizona, on the strength of which it obtained the dismissal

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[1] Compare appellant's assertion at page 30 of its brief that it could not bear "the imminently ruinous cost" of litigation thousands of miles from New York.

of the Union suit for $9,000,000, Dragor was licensed by the Arizona Corporation Commission to transact business in Arizona (R. 42), and the aforesaid acts performed by Dragor involved a transaction out of which Dragor's liability on the aforesaid note arose. The Agreement of Settlement, paragraph 7, so provides (R. 8, 63).

On April 30, 1964, approximately six months after the aforesaid transaction in Arizona, out of which the liability here sued on arose, Dragor, in an obvious attempt to avoid a suit by Union in the Arizona court, sought to withdraw from the Arizona jurisdiction and filed a withdrawal with the Corporation Commission of the State of Arizona (R. 44). The Arizona Corporation Commission permitted such withdrawal conditioned upon and provided that the "said corporation ceased to exist, *except as to creditors.*" (R. 25, 44) (Emphasis supplied.)

Because of the importance of the certificate of withdrawal a photostat thereof is attached hereto as Appendix "A."

At the time this certificate was issued, Union was a creditor of Dragor and had become a creditor by virtue of a transaction occurring in Arizona, namely, the settlement and dismissal of the aforementioned litigation in the United States District Court in Tucson. (See McConnell Affidavit, R. 63.)

Pursuant to Arizona Revised Statutes, §10-481, appellant was required to designate and thereafter maitain in Arizona a statutory agent for the service of process. In 1953, A.R.S. §10-481 was amended to require all foreign corporations not only to maintain a statutory agent but to file with the Arizona Corporation Commission:

"an irrevocable consent to service of pleadings or

> process which shall become effective upon the revocation, annulment or voluntary withdrawal of the license to do business in this state, and which shall provide that actions arising out of or involving business done or transactions arising in this state may be commenced against the corporation in any court of competent jurisdiction within this state, by the service of pleadings or process upon the Commission."

After adoption of the amendment, appellant continued to maintain its license and to transact business in the State of Arizona.

Dragor defaulted in the payment of the moneys due Union on September 30, 1964, and Union thereafter commenced the present action by filing its complaint in the United States District Court for the District of Arizona on December 23, 1964. Copies of the complaint and summons were personally served upon the Arizona Corporation Commission and upon C. T. Corporation, Phoenix, Arizona (R. 12-14). This last company is Dragor's designated statutory agent in Arizona and was such at the time Dragor attempted to withdraw from the jurisdiction of Arizona (R. 71).

In the statement of the case in the Dragor brief, it is claimed that an affidavit filed by Ralph Weiser and containing many arguments and conclusions was binding on the District Court, because not opposed by *seriatim* denials filed by Union. The record does not support Dragor's statement.

In opposition to the motion to quash service of process, Union filed the affidavit of Thomas C. McConnell, which is not denied by Dragor and which sets forth that the certificate issued by the Arizona Corporation Commission contains the express reservation that the said withdrawal was not effective as to Dragor Creditors (R. 44) and that "at the time

of said attempted withdrawal by Ward (Dragor), the plaintiff Union was a creditor of Ward (Dragor) on an obligation created by acts performed in Arizona at a time when Ward (Dragor) was qualified to do business in Arizona, and therefore by the very terms of the affidavit, Ward (Dragor) did not terminate its authority to do business in Arizona as against the plaintiff." (R. 62-63)

After its motion to quash service was overruled and after this court had denied, on March 22, 1965 (R. 169), its petition for a writ of prohibition,[1] Dragor filed an answer and a counterclaim. Subsequently the trial court granted Union's motion for judgment on the pleadings[2] and entered judgment on June 1, 1965 (R. 151). From that judgment the present appeal is taken by Dragor (R. 163-164).

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[1] Once before, Dragor has submitted to this court the jurisdictional argument which it now asserts. In Dragor Shipping Corporation v. The District Court of the United States in and for the District of Arizona, et al., No. 19932, Dragor sought to prohibit the trial judge from proceeding in this matter on the ground that the District Court lacked jurisdiction over the person and that defendant had a counterclaim which it believed included "valid grounds to recover damages from" plaintiff (p. 11, Petitioner's statement of points and authorities, Case No. 19932).

On March 22, 1965, defendant's motion for permission to file a petition for writ of prohibition was submitted for decision and denied by this court.

[2] Dragor has no defense to Union's claim and has made no effort to assert a defense. The lower court granted (R. 184) Union's motion (R. 110) for judgment on the pleadings because the answer failed to assert a defense, and Dragor does not appeal from that ruling.

The motion for judgment on the pleadings was made only with respect to the issues created by the complaint and answer, and judgment was granted under Rule 54(b) (R. 184) with the counterclaim remaining at issue for later trial.

Union has, throughout these proceedings, asserted that the counterclaim was spurious and has at all times been ready and eager to put Dragor to the proof. Trial on the counterclaim was set for December 7, 1965. At that time Dragor failed to appear and its counterclaim was dismissed for lack of prosecution. A transcript of the proceedings on the day of trial is attached as Appendix B. Dragor has now filed a notice of appeal from the judgment of dismissal.

ARGUMENT

I.

THE ARIZONA DISTRICT COURT HAD JURISDICTION OVER THE PERSON OF DRAGOR AND ALSO OVER THE SUBJECT MATTER OF THIS ACTION.

Much of Dragor's argument consists of unsupported assertions. For example, it is stated at p. 14 of its brief that "It appears, without contradiction that the appellant Dragor has not been authorized or qualified to do business in the State of Arizona since April 30, 1964."

The only basis for this statement is a certificate issued by the Arizona Corporation Commission which recited (R. 25) that Dragor had completed "all requirements necessary to permit filing of said withdrawal and thereupon said corporation ceased to exist, *except as to creditors.*" (Emphasis supplied.) (See Appendix A)

Since Union was a creditor at the time and, as we shall show, became a creditor on a transaction taking place in Arizona six months before Dragor attempted to withdraw from Arizona, all of Dragor's argument is beside the point and ignores the fact that under the settlement agreement the obligation upon which this suit was brought did not become effective until the Arizona suits were dismissed. The Agreement of Settlement, although signed by Dragor in New York, called for acts to be performed within the State of Arizona and obviously involved a transaction within the meaning of Arizona Revised Statutes, §10-481(a) (2).

That statute provides that a foreign corporation, before transacting any business in Arizona, shall ap-

point in writing under the hand of its president or other chief officer, attested by its secretary or statutory agent in each county in this state in which the corporation shall carry on business, and file with the Corporation Commission, in the form prescribed by the Commission, "an irrevocable consent to service of pleadings or process which shall become effective upon the revocation, annulment or voluntary withdrawal of the license to do business in this state, and which shall provide that actions *arising out of or involving business done or transactions arising in this state* may be commenced against the corporation in any court of competent jurisdiction within this state, by the service of pleadings or process upon the Commission." (Emphasis supplied.)

Jurisdiction over the subject matter of the action is conceded. Thus, it is admitted in the Dragor brief that there is diversity of citizenship between the parties and that the action involves a sum of money in excess of $10,000, exclusive of interest and costs.

The only question involved here is whether the instant cause of action *involves business done or a transaction arising in the State of Arizona.* Dragor seeks to imply from the citations at pages 15-19 of its brief that there were no transactions in Arizona because the settlement agreement and promissory note were signed in the State of New York. This is a complete *non sequitur* because, as we have already pointed out, the settlement agreement provided for the dismissal of the Arizona suits as a condition to the delivery of the promissory note here in suit.

The cited decisions in the Dragor brief merely express the perfectly obvious proposition that an agreement of compromise and settlement, if fully performed by the parties, supersedes the contract upon

which the original action between the parties was based.

None of them involve a similar fact situation, or support Dragor's claimed lack of jurisdiction argument and hence do not merit discussion in detail. For example, the two Arizona cases cited, *Pacheco v. Delgardo,* 46 Ariz. 401, 52 Pac. 7479, and *Cano v. Arizona Frozen Products Co.,* 38 Ariz. 404, 300 Pac. 953, both involve situations in which a compromise and settlement agreement was held to be invalid because not performed by one of the parties. Because of Dragor's non-performance these cases would rebut Dragor's argument if it were germane.

Defendant does not argue, but attempts to imply that the compromise agreement somehow insulates the defendant from the jurisdiction of the Arizona courts, even though it had done business in Arizona for 17 years, had contracted to perform, and breached, a $7,800,000 contract within the State of Arizona, had a statutory agent there, had engaged in extensive litigation there, and had made an attempted withdrawal from Arizona, subject to the rights of creditors, only after becoming obligated to appellee.

In addition to all this, the settlement agreement perforce was performed in Arizona. In the affidavit sworn to by Thomas C. McConnell and not denied by Dragor (R. 62-63), it is stated: "* * * that the settlement of said suits was only concluded after changes had been made in the settlement proposal by affiant here in Arizona; that affiant refused to permit the said settlement or to permit the dismissal of the said suits in this court until a guarantee of the indebtedness executed by Jakob Isbrandtsen was actually in hand and unless payment of $1,000,000, irrespective of any promissory note or guarantee thereof, was

agreed to by Ward; that the dismissal of the two suits mentioned in the complaint was an act done by Ward in Arizona at a time when both Union and Ward were duly authorized to transact business in the State of Arizona; that the dismissal of the aforesaid suits performed in Arizona constituted the consideration for the aforesaid settlement agreement between Ward and the aforesaid suits in turn concerned transactions which had occurred in Tucson, Arizona, at a time when Ward was authorized to do business in Arizona; * * *" (R. 63)

(a) Jurisdiction over the person of Dragor was secured pursuant to F.R.C.P. Rule 4(d) (3) and Arizona Revised Statutes §10-481.

Rule 4(d) (3) of the Federal Rules of Civil Procedure provides that in any civil action instituted in a United States District Court, personal jurisdiction over a foreign or domestic corporate defendant may be secured by delivering a copy of the summons and complaint in the action to an *"agent authorized by appointment or by law to receive service of process."* (Emphasis supplied.)

An agent so authorized is one designated by a state corporation law which requires as here a foreign corporation to designate an agent to accept process as a condition to doing business in the state.

In *Ex parte Schollenberger,* 96 U.S. 369, 24 L.Ed. 853 (1878), the Supreme Court held that the designation of an agent by a foreign corporation pursuant to such a state law constituted an actual consent to service of process on such statutory agent. Other cases so holding are *Oklahoma Packing Co. v. Oklahoma G. & E. Co.,* 309 U.S. 4, 84 L.Ed. 537 (1939); *Mississippi Public Corp. v. Murphree,* 326 U.S. 438, 90 L.Ed. 185 (1945).

In *Neirbo Co. v. Bethlehem Shipbuilding Corp.*, 308 U.S. 165, 84 L.Ed. 167 (1939), the Supreme Court held that designation of a statutory agent constituted a waiver of venue as well as a method for securing personal jurisdiction over a foreign corporation. The court said, 308 U.S. 170, in holding such appointment constitutes consent to the jurisdiction of the Federal Court:

> "The fact that corporations did do business outside their originating bounds made intolerable their immunity from suit in the states of their activities. And so they were required by legislatures to designate agents for service of process in return for the privilege of doing local business."

Further, such consent to be sued cannot be revoked by a foreign corporation by surrendering its certificate of authority or ceasing to do business where the obligations sued on arose out of or involved transactions previously occurring within the jurisdiction. See *American Railway Express* cases (273 U.S. 269, 71 L.Ed. 639 (1925) and 273 U.S. 274, 71 L.Ed. 642 (1925) and *Houston Fearless Corp. v. Teter,* 318 F2d 822 (CA 10, 1963).

In *Washington ex rel Bond & G. T. v. Superior Court,* 289 U.S. 361, 77 L.Ed. 1256 (1932), the Supreme Court said:

> "The provision that the liability thus to be served should continue after withdrawal from the state afforded a lawful and constitutional protection of persons who had there transacted business with the appellant." (289 U.S. 364)

As we have heretofore pointed out, Arizona Revised Statutes, §10-481 expressly provides that if the suit involves "transactions arising in this state" then service of process on the Commission, as was done here, constitutes lawful service of process on the

absent corporation. Unless it can be held, as a matter of law, that the dismissal of two law suits in Arizona which constituted the consideration for the note sued on here is not a transaction within the purview of the plain language contained in the statute, then there obviously can be no merit in the Dragor contention.

No decision was cited by Dragor in the court below, and none is cited here, holding that the dismissal of the two Tucson suits under the circumstances of this case did not involve a transaction within the statute. The conclusion of Judge Walsh in the court below that substituted service was proper within the terms of the Arizona Statutes is in accord with other authorities construing comparable statutes in other jurisdictions. See *Giusti v. Pyrotechnic Industries,* 156 F.2d. 351 (C.A. 9. 1946); *Gargac v. Smith-Rowland Co.,* 170 F.2d 177 (C.A. 7, 1948); *Ives v. G. R. Kinney Corporation,* 149 F.Supp. 710-712; *Cohen v. Industrial Finance Corp.,* 44 F.Supp. 489 (S.D.N.Y. 1941). See also *Fletcher Encyclopedia Corporation* §§8676-8677.

The appellant seeks to obscure and avoid the effect of the well established principles of substituted service by a long and involved legal argument that a settlement and compromise constitutes a new contract superseding the original cause of action which was sued on between the parties. Conceding *arguendo* that this is so, this fact cannot negative acts and transactions done within the State of Arizona pursuant to a settlement contract executed in the State of New York.

Further, the fact that the settlement contract in the instant case was signed by Dragor in New York has no significance because it is not the signing of the contract of settlement but the acts done pursuant

theerto that created the obligations sued on; namely, the dismissal of the Arizona suits with prejudice. These were acts done in Arizona, not in New York, and certainly acts done in Arizona do not lose their legal significance merely because they are covered by a contract signed in New York. For example, the subcontract between Union and the joint venture was signed in New York and was to be construed under New York law, but no one would seriously contend that the missile site construction contracts at Davis-Monthan Air Force Base at Tucson were not Arizona transactions. Certainly the holdings in all the cases cited at pages 15 to 19 of the appellant's brief have no bearing whatever on the issue presented here.

Under heading B in the Dragor brief, it is further argued, pp. 19 to 31, that the cause of action sued on arose in the State of New York on September 30, 1964 "upon settlement documents executed and delivered in the State of New York."

Here again Dragor misstates the case and ignores the clear and explicit terms of the settlement contract itself. That contract called for the performance of acts in Arizona which had to be performed by Dragor as a condition to the dismissal of the Arizona law suits. See McConnell affidavit (R. 63). The instrument sued on here is a promissory note, the consideration for which was the dismissal of the Tucson suits. That dismissal was a transaction engaged in by Dragor at a time when it was licensed to do business in Arizone and could not in any case be performed in New York. Nor was the note sued on here a valid obligation under the express terms of the New York contract of settlement until these suits were dismissed with prejudice.

Further, the cause of action sued on in the court

below did not arise exclusively in New York, as argued in the Dragor brief. The note itself provided that it should be construed by Illinois law, but the transaction it grew out of *was the settlement and dismissal of Arizona litigation.* It was only after the suits were dismissed that Union had a valid obligation.

Even though stipulations to dismiss had been executed the cases could only be dismissed by the order of Judge Walsh which could only be entered in Arizona.

The fact that Dragor did not default on its promissory note until after it had attempted to withdraw from Arizona has no bearing under a statute which provides for substituted service on actions "arising out of or involving business done or transactions arising in this state * * *."

However, Dragor places great reliance on this argument and cites a New York case in an attempt to support it.

Boas v. Vernier, 22 App.D.W.2d 561, 257 N.Y.S.2d 487, is the case so cited and is based on Section 302 of New York Civil Practice Law and Rules, which gives jurisdiction over a corporation which . . . "transacts any business within the state."

The New York statute "does not occupy the full jurisdictional field permitted," and is obviously much more restricted in scope than A.R.S. §10-481, but nevertheless appellant cites, *and quotes,* from *Boas* at length to support its assertion that appellant can be sued only in New York because that is where it executed the Agreement of Settlement.

A reading of the quotation from *Boas* at page 29 of appellant's brief seems to support its argument,

but a reading of the decision itself demonstrates that appellant has omitted, without indicating it has done so, a most important clause (257 N.Y.S.2d 487, 489): The actual quotation should read as follows:

> "The complaint seeks the agreed commissions earned by plaintiff as broker and consultant in introducing defendant to certain French underwriters and rendering other services leading to the merger of a French corporation of which defendant was principal stockholder and chief executive officer into a new French corporation. In the absence of any showing that the oral agreement with defendant was negotiated or concluded by defendant in New York, *or that defendant did any other act with respect to the oral agreement in New York,* it cannot be said that the causes of the action arose from an act of defendant in the transaction of business within the State (CPLR 302(a) (1)). The fact that a prior written agreement was historically necesary to the inception of the subsequent oral agreement does not alone, for purposes of the jurisdiction statute, support personal jurisdiction."

Appellant completely omitted the italicized material.

We have found no decisions sustaining Dragor's position, and the law of New York is emphatically to the contrary.

On May 27, 1965, New York's highest appellate court wrote one consolidated opinion in three cases which involve CPLR 302. Two of these cases involve assertion of jurisdiction over a non-domiciliary transacting business in New York, while the third, not relevant here, involved a provision of CPLR 302 relating to tortious conduct within the state.

Longines-Wittnauer Watch Co., Inc. v. Barnes & Reinecke, 261 N.Y.S.2d 8, 22, 209 N.E.2d 80, and *Singer v. Walker,* 261 N.Y.S.2d 8, 24, 209 N.E.2d 80,

were each cases in which the defendant claimed that the contract on which its liability was based was executed in a state other than New York.

In *Singer v. Walker,* the defendant had manufactured a hammer in Illinois, shipped it to New York where it was purchased by plaintiff who was injured while using it in Connecticut. The New York Court of Appeals said (261 N.Y.S.2d 8, 26):

> "We hold that the appellant's activities in this state are sufficient to satisfy the statutory criterion of transaction of business as well as the constitutional requirement of 'minimum contacts'. (See International Shoe Co. v. Washington, 326 U.S. 310, 319-320, 66 S.Ct. 154, 90 L.Ed. 95; supra; McGee v. International Ins. Co., 355 U.S. 220, 223, 78 S.Ct. 199, 2 L.Ed.2d 223, supra.) *For the reasons we gave in rejecting a similar contention in the Longines-Wittnauer case* (supra, 15 N.Y.2d pp. 456-458, 261 N.Y.S.2d 22, 209 N.E.2d 80), *we do not deem it determinative, as urged by the appellant, that the formal execution of its sales contracts may have occurred in Illinois rather than New York.*" (Emphasis supplied.)

This court's latest pronouncement on the point is to the same effect:

> "Moreover, the decisions are clear that even though, in a technical sense, the facts giving rise to the cause of action may have occurred outside of the state, this is not a bar to the assertion of jurisdiction by the state, particularly where there are activities in the state which relate to the cause of action. That we think is certainly the case here. Some cases have held that, if a corporation

> is doing business in the forum state, it is immaterial that the cause of action arose elsewhere. Here, we need not go so far. (Citing cases.) *Mechanical Contractors Ass'n. v. Mechanical Con. A. of N. Cal.,* 342 F.2d 393; 398 (C.A.9, 1965).

What Dragor seeks to obscure is that the transaction here involved took place in Arizona after and not prior to the execution of the settlement documents in the State of New York. Thus, Dragor says at p. 20 of its brief: "Any matter, fact or circumstance occurring prior to the execution of the settlement documents" is "totally irrelevant under the decisions of the United States Supreme Court in determining the constitutional power of a state to subject non-residents to its process." What Dragor refuses to face up to is the fact that the dismissal of the Arizona suits which was the consideration for the note sued on occurred in Arizona at a time subsequent to the execution of the settlement documents in the State of New York.

At page 21 of the Dragor brief, the conclusion of the court in *L. D. Reeder Construction of Arizona v. Higgins Industries,* 265 F.2d. 768, 773, is cited as conclusive and determinative of the question presented here.

There the court said:

> "We note that the acts which have a substantial connection with the state are acts which also have a substantial and, indeed, direct connection with the cause of action sued upon, i.e., the cause of action arises by reason of acts so connected. When this double substantial connection exists, then, in view of the broad language of *McGee v. International Life Ins. Co.,* supra, a single act or transaction may be the basis for jurisdiction over a non-resident defendant."

While that case is no help to Dragor because the non-resident corporation had never qualified to do business, still that language fits the instant case like a glove. The obligation sued on here could not and did not arise until the Arizona cases were dismissed. This was done by Dragor in Arizona at a time when it was authorized to do business as a foreign corporation in Arizona.

The other cases cited at pp. 23 to 31 of the Dragor brief are also clearly distinguishable on their facts. None of them involved a foreign corporation that had qualified to do business in the state whose jurisdiction was attacked. Likewise, none of the defendants had consented to substituted service by exercising the privilege granted of doing business in the state. The distinction is pointed out by Chief Justice Warren in his opinion in *Hanson v. Denckla* cited at page 22 of the Dragor brief.

There he said:

> "Thus there is established as essential some act by which the defendant 'purposefully' seeks the privilege of conducting activities within the forum state and attaining the benefit and protection of its laws. This essential act of the defendant must give rise to or result in a cause of action within that forum state."

In the instant case, Dragor first obtained a certificate of authority from the Arizona Corporation Commission to transact business within the State of Arizona on July 29, 1947. It continuously maintained that license for a period of 17 years, having sought permission to withdraw from Arizona only after it had decided to default on the million dollar note. At all times material here, it has maintained a statutory agent within the state upon whom notices and process might be served.

Dragor's attempt to portray itself as an innocent foreign corporation called before a court in a distant jurisdiction upon a claim based on nothing involving any transaction in Arizona, did not deceive the District Court and we feel sure will likewise not mislead this court. As pointed out in Appellant's Statement of Facts, Dragor initiated litigation against Union in Arizona and insisted that Union's action be removed to Arizona.

(b) Jurisdiction over the person of Dragor was also obtained pursuant to F.R.C.P. Rule 4(d) (7) and Arizona Statutes and Rules.

In addition to serving process on Dragor pursuant to Rule 4(d) (3), providing for service of process upon an agent authorized by appointment or by law, process was served on Dragor's statutory agent pursuant to F.R.C.P. Rule 4(d) (7), which provides that it "is also suficient if the summons and complaint are served in the manner prescribed by the law of the state in which the District Court is held for the service of summons or other like process upon any such defendant in an action brought in the courts of general jurisdiction of that state."

The state law referred to in this Federal Rule includes the provisions of Arizona Rules of Civil Procedure, Rule 4(d) (10) which states that:

> "When a domestic corporation does not have an officer or agent in this state upon whom legal service of process can be made (service shall be effected) by depositing two copies of the summons and complaint in the office of the Corporation Commission which shall be deemed personal service on such corporation."

Arizona Constitution, Article 14, §§5 and 8 also

provide in effect that foreign corporations cannot be made subject to service of process on terms more favorable than domestic corporations. *Arizona Barite Co. v. Western Knapp*, 170 F2 684 (CA 9, 1948).

The state law referred to in F.R.C.P. Rule 4(d) (7) also includes Arizona Revised Statutes, Section 10-484.01(a), which provides:

> "All appointments of statutory agents by a foreign corporation made prior to and which are in effect on June 30, 1958, shall continue in full force and effect until revoked as provided in subsection b."

Subsection b (Arizona Revised Statutes, Section 10-484.01[b]) makes no provision for revocation of the appointment of statutory agents upon surrender of a certificate of authority, but states only that if "the corporation has appointed more than one statutory agent in this state, it may file with the Corporation Commission a certificate * * * designating one of such statutory agents as its statutory agent pursuant to Section 10-481 * * *." The Arizona statute thereby establishes that the designation of a statutory agent is not automatically revoked when a foreign corporation surrenders its certificate of authority to transact business.

The foregoing provisions, made applicable in this action by reason of F.R.C.P. Rule 4(d) (7), thus authorize service of process upon Dragor, either by serving its statutory agent C. T. Corporation or by serving the Arizona Corporation Commission.

This was the conclusion reached in *Arizona Barite Co. v. Western-Knapp Engineering Co.*, 170 F.2d 684 (C.A. 9, 1948), where this court held that a foreign corporation through withdrawal could not immunize

itself from suit on claims arising out of transactions occurring within the State of Arizona prior to such attempted withdrawal. In holding that service on either the last designated statutory agent or on the Arizona Corporation Commission was necessarily valid, this court declared, at page 687:

> "If an Arizona corporation similar to appellee has transacted business in Arizona, an action on any claim arising out of such business can be brought against such corporation in Arizona after it has ceased to transact business in Arizona. If such corporation has a statutory agent in Arizona, service of the summons in such action can be made as provided in §21-305, and such service is valid. If such corporation has in Arizona no officer or agent upon whom legal service of process can be made, service of the summons in such action can be made as provided in §21-314, and such service is valid. These are conditions on which an Arizona corporation similar to appellee is allowed to transact business in Arizona. *Appellee was not and could not be allowed to transact business in Arizona on more favorable conditions.*" (Emphasis supplied.)

Service of process upon Dragor in the present action is in all respects identical with the service of process effected in the *Barite* case (R. 14). It is an exact precedent for sustaining service of process in this action in the manner provided by the State of Arizona law as understood and applied by this Court of Appeals.

The *Barite* principle has since been followed by the Eighth Circuit in *Electrical Equipment Co. v. Hamm,* 217 F.2d. 656 (1954), where that court reversed a judgment dismissing the complaint for want of jurisdiction on the ground that the defendant had

ceased to transact business in the state. The Eight Circuit declared at page 663 of its opinion:

> "Defendant further argues that since process was not served until some nine months after defendant's activities in the state ceased, the defendant was not doing business in Iowa at the time of service of the notice and that service could not be made upon it in June of 1953. This contention is not sound. A foreign corporation which has ceased to do business in a state is still subject to service of process in suits or causes of action which arose out of the business carried on by the defendant in the state."

Barite was also relied upon in *Gibbons & Reed v. Standard Accident Insurance Co.*, 191 F.Supp. 174 (D.C. Utah 1962).

The *Barite* decision is wholly consistent with *International Shoe,* 326 U.S. 310, and with this court's decisions in *Reeder* and *Kourkene* which stand for the proposition that in order to create jurisdiction over a non-resident because of the commission of a single act, that act must be directly connected with the cause of action. In each of those cases the foreign corporation had not qualified to do business in the state in which service of process was had.

In *Reeder,* 265 F.2d 768, 769, this court points out:

> "Here the defendant, never qualified to do business in California, had no paid employees in the state; no office or sample room; no office address; no telephone listing. It accepted the order, placed by McCauley in Louisiana; it shipped the product direct to Arizona. The product was never in California * * *."

In *Kourkene,* 313 F.2d 769, this court comments:

> "There is no evidence that appellee has ever qualified to do business in this state * * *."

CONCLUSION

For 17 years Dragor has secured the benefit and protection of Arizona law, not withdrawing from that jurisdiction until after its default in the performance of its subcontract with Union, out of which the present claim arose, and until it had decided to default on the million dollar promissory note which is the subject matter of this suit. Its withdrawal certificate is limited and merely provides that it is no longer present in Arizona "except as to creditors," and Union clearly qualifies as a creditor entitled to employ substituted service pursuant to the provisions of Arizona law.

We have shown that Dragor's reliance on the "single act" decisions of the Supreme Court is misplaced but even if only a single transaction was here involved those cases are distinguishable because the corporations involved had never been licensed in the forum state.

For the reasons advanced in this brief, we submit that the judgment entered in the court below should be affirmed.

Respectfully submitted,

THOMAS C. McCONNELL
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By H. C. WARNOCK

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CERTIFICATE OF COMPLIANCE

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

H. C. Warnock, *Attorney*

APPENDIX A

STATE OF ARIZONA

Corporation Commission

To all to Whom these Presents shall Come, Greeting:

I, S. C. CORBITT, SECRETARY OF THE ARIZONA CORPORATION COMMISSION, DO HEREBY CERTIFY THAT the records of the Arizona Corporation Commission show WARD INDUSTRIES CORPORATION, a DELAWARE, corporation qualified on the 29th day of July, 1947, and existing under and by virtue of the laws of the State of Arizona, deposited in the office of the Arizona Corporation Commission, a WITHDRAWAL, and did on April 30, 1964, complete all requirements necessary to permit the filing of said Withdrawal and thereupon said corporation ceased to exist, except as to creditors.

IN WITNESS WHEREOF, I HAVE HEREUNTO SET MY HAND AND AFFIXED THE OFFICIAL SEAL OF THE ARIZONA CORPORATION COMMISSION, AT THE CAPITOL, IN THE CITY OF PHOENIX, THIS 30th DAY OF April A. D. 1964

BY S. C. Corbitt SECRETARY.

ASSISTANT SECRETARY

APPENDIX B

IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

UNION TANK CAR COMPANY,
Plaintiff,

vs.

DRAGOR SHIPPING CORPORATION,
Defendant.

No. Civil
1967

APPEARANCES:

MR. THOMAS McCONNELL and
MESSRS. BOYLE, BILBY, THOMPSON & SHOENHAIR, by
MR. HAROLD C. WARNOCK
For the Plaintiff

NO APPEARANCE ON BEHALF OF THE DEFENDANT

The above-entitled matter came up for trial on the 7th day of December, 1965, at the hour of 9:30 o'clock a.m., at Tucson, Arizona, before the Honorable James A. Walsh, Judge, and the following proceedings were had, to-wit:

(Clerk calls the case.)

MR. WARNOCK: The plaintiff Union Tank Car Company is present and ready to proceed, Your Honor.

No. 20416

United States Court of Appeals

FOR THE NINTH CIRCUIT

DRAGOR SHIPPING CORPORATION, a corporation, formerly WARD INDUSTRIES CORPORATION,

Appellant,

vs.

UNION TANK CAR COMPANY, a corporation,

Appellee.

REPLY BRIEF OF APPELLANT, DRAGOR SHIPPING CORPORATION

Upon Appeal from the District Court of the United States for the District of Arizona

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Of Counsel

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Upon Appeal from the District Court of the United States for the District of Arizona

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The Position of Union Upon This Appeal

In its brief upon this appeal (pp. 9-10, 13), Union has virtually conceded the established universality of the rule of law set forth in Dragor's opening brief (pp. 15-19) that a settlement and compromise constitutes "a new and superior contract *superseding and extinguishing* the contract or contracts upon which the original action between the parties was based, *and the action itself.*" * (*Moers* v. *Moers,* 229 N. Y. 294, 300). Necessarily, therefore, upon the execution and delivery of the settlement agreement and promissory note in New York on October 3, 1963, "the old causes of action were terminated. A new liability was substituted therefor." (*Yonkers Fur Dressing Co.*

---

* Unless otherwise noted, all italics will be ours.

v. *Royal Insurance Company,* 247 N. Y. 435, 444, 446.) With regard to the existing lawsuits thus settled and compromised, "it was as if they had never been begun." (*Yonkers Fur Dressing Co.* v. *Royal Insurance Co., supra,* 444, 446). "The compromise agreement becomes the *sole source and measure* of the rights of the parties involved in the previously existing controversy." (*Wilson* v. *Bogert,* 81 Idaho 535, 347 Pac. 341, 345).

As an indispensable corollary to these rules of law, it is clear that the situs of the actions thus extinguished, "as if they had never been begun", cannot possibly constitute the constitutional basis for the assumption of the jurisdiction over a non-resident upon the superseding obligation by any State other than the State where that new obligation was created and allegedly breached. Recognizing the patent applicability of these rules of law, Union has virtually abandoned upon this appeal the arguments with which it urged the District Court below to assume jurisdiction over the person of Dragor in this case. In their place, for the very first time, Union presents, and bases its entire brief upon, brand new arguments in its attempt to sustain the unconstitutional assumption of jurisdiction *in personam* over Dragor in this case.

Those newly devised contentions are twofold in number. Not only are they completely contradicted by the incontrovertible facts contained in this record, including the very documents executed and delivered by and between the parties in New York on October 3, 1963, but each is mutually destructive of the other. Briefly summarized, Dragor's new position is as follows:

1. That "the settlement agreement provided for the dismissal of the Arizona suits as a *condition* to the delivery of the promissory note here in suit" (Union's Brief, p. 9); that the promissory note upon which Union sues *"did not become effective* until the Arizona suits were dismissed (Union's Brief, p. 8); and that "it was *only after* the suits were

dismissed that Union had a valid obligation" (Union's Brief, p. 15); and

2. That *the consideration* for the execution and delivery of Dragor's promissory note "was the dismissal of the Tucson suits" (Union's Brief, p. 14); that the dismissal "was an act *done by Ward* (Dragor) in Arizona" (Union's Brief, p. 11); and that it allegedly "occurred in Arizona *at a time subsequent* to the execution of the settlement documents in the State of New York." (Union's Brief, p. 18).

Thus, on the one hand, Union argues that the routine and ministerial act of filing stipulations of discontinuance in the Arizona suits was a *condition precedent* to the immediately binding effect of the promissory note and settlement documents in suit and, on the other, that the act of filing was "*subsequent* and took place in Arizona *after and not prior* to the execution of the settlement documents in the State of New York." (Union's Brief, p. 18).

Each of these mutually contradictory and self-destructive contentions will now be considered in turn. We shall demonstrate that each is based upon an indefensible disregard of the record, and that neither can justify the District Court's assumption of jurisdiction over the person of Dragor in this action instituted against Dragor upon the promissory note and settlement agreement which it made, executed, delivered and allegedly breached in the State of New York.

I

The Promissory Note and Settlement Agreement, as well as the other documents required thereunder, were all unconditionally executed and delivered by and between the parties in the State of New York on October 3, 1963 and immediately became effective on that day as binding and subsisting New York obligations.

Union's present thesis is expressed in the following extracts from its brief:

On page 4, it is stated that "the delivery of the aforesaid promissory note for $1,000,000.00 (executed and delivered by Dragor to Union on October 3, 1963) was *conditioned* upon the dismissal of said suits (in Arizona) and upon execution of the settlement agreement." (Matter in parentheses ours).

At page 8, it is stated that "under the settlement agreement the obligation upon which this suit was brought *did not become effective* until the Arizona suits were dismissed."

At page 9, it is stated that "as we have already pointed out, the settlement agreement provided for the dismissal of the Arizona suits *as a condition to the delivery of the promissory note here in suit.*"

At page 14, it is stated *"nor was the note sued on herein a valid obligation* under the express terms of the New York contract of settlement *until these suits were dismissed with prejudice.*"

At page 14, it is stated that "it was *only after the suits were dismissed* that Union had a valid obligation."

At page 19, it is stated that "the obligation sued on here *could not and did not arise until the Arizona cases were dismissed.*"

In summary, then, it is clear that Union is now contending that the Promissory Note and Agreement of Settlement, as well as the other documents required thereunder, all of which were simultaneously executed and delivered by and between the parties in the State of New York on October 3, 1963, were not, in fact, delivered and did not, in fact, become immediately binding and effective until, as a condition precedent thereto, the stipulations of discontinuance were filed in the Arizona suits.

The quoted assertions with which Union has filled its brief are based upon a total disregard of the record. To the exact contrary, all of the documents executed and delivered in New York on October 3, 1963 became *by their terms* immediately binding and effective on that day. Not a single one of these instruments remained undelivered on that day. Not a single one of these documents was placed in escrow on that day to await the occurrence of any other event. Not a single word is contained anywhere in the record, either in the documents executed and delivered on that day, or in any other instrument of any kind, nature or description, which directly or indirectly, expressly or impliedly, even remotely hinted or suggested that the promissory note and settlement agreement were not to become immediately binding and effective as valid and subsisting obligations until the purely ministerial and perfunctory act of filing the stipulations of discontinuance in Arizona and California had taken place.

The documents themselves speak more eloquently and conclusively upon this subject than any words which counsel can utter. What do those documents say?

(1) The Promissory Note: The promissory note upon which Union has based Count II of its complaint (R., pp. 10-11), executed and delivered by Dragor to Union in New York on October 3, 1963, specifically provides:

> "WARD INDUSTRIES CORPORATION, a corporation, for value received, *hereby* promises to pay to UNION TANK CAR COMPANY, a corporation, on September 30, 1964, the sum of $1,000,000 with interest . . .
>
> The amount due under this note is subject to reduction by any amounts due WARD INDUSTRIES CORPORATION from UNION TANK CAR COMPANY *under an agreement between the said parties dated this date,* a copy of which is attached hereto as Exhibit 'A' ".

With respect to that instrument, the plaintiff alleged, under the signature of its present counsel, that (R., p. 3):

> *"On October 3, 1963 the defendant,* whose corporate name was then Ward Industries Corporation, for a valuable consideration, *made, executed and delivered a promissory note,* a copy of which is annexed hereto as Exhibit B, ..."

(2) The Agreement of Settlement: The Agreement of Settlement, executed and delivered by both Union and Dragor on October 3, 1963, upon which the plaintiff has based Count I of its complaint (R. pp. 2-3), recites in the very first paragraph thereof that it was *"made* this 3rd day of October, 1963" (R. p. 5). Paragraph 1 reads as follows (R. p. 6):

> "UNION and WARD *hereby mutually release each other* from any and all actions and claims, regardless of the nature or description thereof, and whether or not now known, excepting solely and only those actions or claims specifically set forth in this agreement."

Paragraph 5 reads as follows (R. p. 7):

> "WARD *shall pay to* UNION on or before September 30, 1964 the sum of One Million ($1,000,000.00) Dollars. . . .

Paragraph 6 reads as follows (R. p. 8):

> "*A guarantee* by Mr. Jakob Isbrandtsen of the foregoing note and obligation of WARD in the form attached hereto as Exhibit 'A' *shall be delivered simultaneously upon execution of this agreement.*"

(3) Assignment: Paragraph 4 of the Agreement of Settlement required Dragor "to assign to WILLIAM B. BROWDER" Union's General Counsel, its claims against Union, The Fluor Corporation, Ltd. and the United States Government (R. p. 7). Such an assignment was duly executed and delivered by Union to Dragor on October 3, 1963 in the State of New York, the instrument reciting in part as follows (R. p. 109):

> "For good and valuable consideration, *receipt of which is hereby acknowledged*, the undersigned does *hereby* assign to WILLIAM B. BROWDER, an individual, all of the undersigned's right, title and interest to any and all claims which it has or may have against Union Tank Car Company and/or THE FLUOR CORPORATION and/or the United States Government . . ."

(4) Covenant Not To Sue: Simultaneously also with the execution of these documents, the parties executed and delivered a "Covenant Not To Sue", which reads as follows (R., pp. 26-27; 107-108):

> "In consideration of the execution of an Agreement of Settlement between UNION TANK CAR COMPANY (hereinafter referred to as 'Union') and WARD INDUSTRIES CORPORATION (hereinafter referred to as 'Ward'), *on this date*, and notwithstanding Paragraph '2' of the aforesaid Agreement of Settlement, Union and Ward *hereby* agree:
>
> 1. Neither Union nor Ward shall assert a claim against the other in connection with the action entitled 'United States of America for the use and benefit of

> Mosher Steel Company, and Mosher Steel Company, Plaintiffs, against The Fluor Corporation, Ltd., et al, Defendants', No. Civ. 1605-Tucson, or in any action which may result from a claim asserted by Mosher Steel Company against Union or Ward, and in the event that a judgment shall be rendered in the aforesaid action, or any other action instituted by the Mosher Steel Company against Union or Ward, neither party shall assert any rights to recover against the other as a result of such judgment. It is the intent of this paragraph that neither Ward nor Union shall pursue the other in connection with any claims by Mosher Steel Company against Union or Ward." * * *

It is an eloquent commentary upon Union's recognition of its present indefensible position that it should have been compelled to resort to so easily demonstrable a disregard of the record. Moreover, we can find nowheres in Union's brief any legal support for the legal argument which it has based thereon, even assuming, *arguendo,* the accuracy of its factual assertions.

It will be instructive to test Union's reliance upon the act of filing the stipulations of discontinuance in Arizona, assuming it to be, *arguendo,* a condition precedent, by this Court's definitive analysis in *L. D. Reeder Contractors of Arizona* v. *Higgins Industries,* 265 F. (2d) 768 of the due process requirements for jurisdiction *in personam.*

In reviewing *Hanson* v. *Denckla,* 357 U. S. 235, this Court in *L. D. Reeder* noted: (1) that the settlor of the Delaware trust subsequently moved to Florida; (2) that there had been correspondence between the Delaware trustee and the settlor in Florida; (3) that income had been paid by the Delaware trustee to the settlor in Florida; and (4) that the settlor had exercised in Florida a power of appointment over the trust reserved to the settlor by the terms of the trust. None of these acts, singly or collectively, were suffi-

cient to support the *in personam* jurisdiction of the Florida courts over the Delaware trustee.

This Court observed that, under *Hanson* v. *Denckla, supra,* the act of the non-resident in the forum state, necessary to sustain its jurisdiction over his person, must be "essential" or substantial *and* "must give rise to or result in a cause of action within that forum state" (p 773). It thereupon concluded, and its conclusion is dispositive of this appeal, that the act upon which personal jurisdiction is sought to be based must have a "*double substantial connection*" with the forum: first, it must have "a substantial connection with the state", i.e., it must constitute a *substantial* business act or transaction "purposefully" performed in the forum state; and second, it must "have a *substantial* and, indeed, *direct* connection with the *cause of action sued upon;* i.e., *the cause of action arises* by reason of acts so connected" (p. 773). Consequently, it is only "when this *double* substantial connection exists" that "a single act or transaction may be the basis for jurisdiction over a non-resident defendant".

In the instant case, the act of filing the stipulations of discontinuance satisfies *neither* requisite of the "double substantial connection" with the forum state prescribed by this Court and the United States Supreme Court. Firstly, the filing was not a substantial business act or transaction. After the parties had unconditionally released each other in New York of "any and all actions and claims, regardless of the nature and description thereof . . ." (R., p. 6), the filing of a stipulation implementing that release, in Arizona, California and elsewhere, was a routine and ministerial entry upon the court files of the termination of a suit already and previously extinguished.

Secondly, the act of filing the stipulations did not have, and could not possibly have had, "a substantial" or "direct connection with the cause of action sued upon." The plaintiff's causes of action are based upon Dragor's alleged fail-

ure, in New York, to pay a promissory note which it executed and delivered in New York. The act of filing had nothing whatsoever to do with, let alone "give rise to or result in", the causes of action set forth in the plaintiff's complaint. In the language of this Court in *Kourkene* v. *American BBR Inc.,* 313 Fed. (2d) 769, 773, speaking of some activities of the appellee in California, "Since it is clear that the appellant's cause of action did not arise out of or result from any of these activities", the District Court lacked jurisdiction *in personam.*

On December 15, 1965, the Circuit Court of Appeals for the Second Circuit rendered its decision in *Harvey* v. *Chemie Grunenthal,* N. Y. Law Journal, January 10, 1966, p. 1.* In that case, an action was brought in the United States District Court, Southern District of New York, by the plaintiff, who had purchased pills called "Contergan" in Germany which were manufactured and distributed by a German company. When she returned to this country, the plaintiff became pregnant, and, as a result of those pills, gave birth to deformed children, the pills containing Thalidomide, a highly toxic and especially dangerous element to infants in foetus. The action was brought in New York. The District Court dismissed the complaint for lack of jurisdiction *in personam.* In affirming the judgment of the Court below, the Circuit Court of Appeals rendered a comprehensive and definitive opinion upon the issue of jurisdiction *in personam* over non-residents. The following portion of its opinion is dispositive of the issues presented herein:

> "It is doubtful whether the scattered activity of Chemie Grunenthal in New York constitutes the transaction of business within the state. But even if we could hold that the engaging of a New York attorney, the conclusion of a product license agreement with a

* The opinion of the Circuit Court has not yet been officially reported.

company with offices in New York City, and the shipment of samples through a New York port *constituted the transaction of business in New York*, the appellants would still fail to come within CPLR, section 302(a) (1), *for the appellants' cause of action was not one 'arising from' this business activity.*"

II

The filing of the stipulations in Arizona was not, as Union claims, "an act done by Ward in Arizona" (Union Brief, p. 11) which constituted "the consideration for the note sued on here" (Union Brief, p. 13).

It is claimed by Union that the consideration for Dragor's execution and delivery of the promissory note in suit "was the dismissal of the Tucson suits" (p. 14) and that such dismissal "was an act *done by Ward* in Arizona" (p. 11). We are thus presented with the unprecedented theory in contract law that the consideration for the execution and delivery of Dragor's promissory note was an act performed by Dragor itself; in short, that Dragor itself had furnished the consideration for its own promissory note. Union has apparently overlooked the elementary maxim of contract law that the consideration for a valid and enforceable promise must be furnished by the promisee, and not the promisor.

What were the several considerations furnished to Dragor in New York on October 3, 1963 by Union for Dragor's note? First, Union released Dragor and Dragor reciprocally released Union "of any and all actions and claims, regardless of the nature or description thereof and whether or not now known" (R., p. 6). Secondly, Union waived any right to claim over against Dragor in the Mosher suit then pending against both, with a reciprocal waiver by Dragor of its right to claim over against Union in that action. Thirdly, Union insisted upon receiving, and did

receive, an assignment of Dragor's claims under its subcontract which it agreed to prosecute with dispatch and credit Dragor with stipulated percentages of its recovery. Fourthly, to implement in part the general releases, both Union and Dragor executed stipulations of discontinuance in New York of the actions then pending in Arizona, California and elsewhere, which stipulations were thereafter filed in the Arizona and California Courts.

These, then, constituted the totality of the considerations furnished by Union to Dragor in the State of New York on October 3, 1963. The filing of the stipulations in Arizona, California and elsewhere took place, in Union's words "*after and not prior* to the execution of the settlement documents in the State of New York", (Union brief, p. 18). The act of filing was not a "substantial" business transaction at all. It was merely routine, ministerial and perfunctory, to record upon the files of the Courts the extinguishment of law suits which had already been effected by the general releases previously exchanged in New York. *No decision of any state or federal court has ever held, under any standard ever before applied, that the filing of such a stipulation constituted the transaction of business, substantial or otherwise, by a foreign corporation in a forum state.*

Moreover, the act of filing was completely unrelated to the cause of action upon the promissory note executed and delivered by Dragor in the State of New York. The settlement agreement executed in New York constituted "*the sole source and measure* of the rights of the parties involved in the previously existing controversy." (*Wilson* v. *Bogert*, 81 Idaho 535, 347 P. (2d) 341, 345). The total insufficiency of Union's argument that the filing of the stipulations in Arizona constituted, in some way, the constitutional nexus and support for the District Court's *in personam* jurisdiction over Dragor for its alleged default upon the promissory note is underscored by the following decisions:

In *Irgang* v. *Pelton & Crane Co.*, 42 Misc. (2d) 70, (N. Y. 1964) the defendant, a North Carolina corporation, was engaged in the manufacture and distribution of dental equipment and supplies. By a North Carolina contract, the plaintiff agreed to assign to the defendant her rights to certain trade names, trademarks and patents, in return for certain royalties. *The plaintiff executed the documents assigning her trade name, trademark and patent rights to the defendant in New York.* Upon the defendant's failure to pay the royalties, the plaintiff commenced an action in New York. In spite of the fact that the plaintiff had executed the documents assigning her trade name, trademark and patent rights to the defendant in New York, the New York Court dismissed the action upon the ground that it did not possess any *in personam* jurisdiction over the North Carolina corporation. It emphasized the fact that the plaintiff's cause of action did not relate to or arise out of the execution of the assignment in New York, and that the assignment documents had been signed in New York *to fulfill the requirements of the contract previously executed in North Carolina.* The Court held (p. 73):

> "Plaintiff did sign the documents of assignment of her trade name and mark and her patent rights to defendant in New York, *but these did not constitute another contract;* these documents were signed *to fulfill the requirements of the contract previously executed in North Carolina,* and the cause of action herein is for *the alleged breach of that North Carolina contract.*"

In *Erlanger Mills, Inc.* v. *Cohoes Fibre Mills, Inc.*, 239 F. (2d) 502, Erlanger, a North Carolina corporation, entered into an agreement in New York to purchase a quantity of synthetic yarn from the defendant, a New York corporation. The defendant shipped the goods to Erlanger in North Carolina. Erlanger paid therefor with a check from North Carolina. It then discovered alleged defects in the

goods when it attempted to process those goods in North Carolina. It thereupon brought a suit in the North Carolina State Court to recover for the alleged defects in the goods. The action was removed to the North Carolina Federal District Court, where service was quashed upon the ground that the North Carolina did not possess jurisdiction *in personam* over the defendant company. In spite of the fact that the goods had been shipped by the defendant into North Carolina, that they had been paid for in North Carolina and that the defects in the goods became only apparent in North Carolina, the Circuit Court of Appeals for the Fourth Circuit, in affirming a dismissal of the complaint, declared: (p. 507)

> "We cannot shut our eyes to the disorder and unfairness likely to follow from sustaining jurisdiction in a case like this. It might require corporations from coast to coast having the most indirect, casual and tenuous connection with a State to answer frivolous law suits in its courts. To permit this could seriously impair the guarantees which due process seeks to secure."

If, as in the *Irgang* case, *supra,* the plaintiff's execution of the assignment in New York of her trade name, trademark and patent rights was not sufficient to constitute a constitutional nexus with the forum state; and if, as in the *Erlanger* case, *supra,* the receipt of the goods in North Carolina and the payment therefor in North Carolina were equally insufficient to furnish that constitutional nexus, then *a fortiori,* the filing of a stipulation of discontinuance which, as the New York Court noted, was filed *"to fulfill the requirements of the contract previously executed",* could not possibly support an *in personam* jurisdiction of the Arizona District Court.

III

No other argument advanced or authorities cited by Union can support the decision of the court below.

(1) We now turn to a consideration of the miscellaneous assertions and arguments presented by Union in its behalf, none of which can furnish the slightest support for the judgment appealed from. Thus, we are told that "the settlement of said suits was only concluded after changes had been made in the settlement proposal by affiant (Thomas C. McConnell, Union's Chicago attorney) here in Arizona . . ." (Union Brief, pp. 10-11). The contemplation by *Union's attorney* of the proposed settlement in Arizona, and his Arizona thoughts thereon, can hardly furnish a constitutional basis under the due process clause for Arizona's assumption of an *in personam* jurisdiction over a non-resident defendant. The requirements of our Federal Constitution can hardly hinge upon the place where *Union's counsel* engaged in cerebration.

(2) Throughout the course of its brief, Union has persistently charged, without a shred or scintilla of supporting proof, that "Dragor defaulted" in the performance of the original subcontract (p. 1); that it "failed to complete the subcontract" (p. 3); that Union "was forced to complete the same at an excess cost of approximately $9,000,000 (p. 3); and finally, that Dragor withdrew from Arizona "after its default in the performance of its subcontract with Union" (p. 24). It is also stated that Dragor "did not deceive the District Court and will likewise not mislead this Court" (p. 20).

These assertions are deliberately designed to prejudice the appellant in the eyes of this Court. They have no place upon this appeal. The execution of the settlement agreement, as Union should now know, does not constitute, and cannot possibly constitute, evidence of any "default" or an admission thereof. It represents, solely, "a desire to avoid or seek a surcease of litigation on the part of the defend-

ant . . ." (*Quillen* v. *Board of Education,* 203 Misc. 323 [N. Y.]).

(3) We are told by Union in its brief that the New York decisions, particularly *Longines-Wittnauer* v. *Barnes and Reinecke,* 15 N. Y. (2d) 443, are contrary to Dragor's position herein (p. 16). Union has completely misread that New York decision. It represented a consolidation, on appeal, of three cases: one, a contract action and two tort suits.

In the contract action, a suit was brought by Longines-Wittnauer against Barnes and Reinecke for breach of warranty in the manufacture and sale of machines especially designed for the plaintiff New York corporation by the defendant Illinois company. The following acts were established: (1) The preliminary contract negotiations were conducted in New York over a period of two months; (2) The contract itself, though signed in Chicago, contained an express provision that it was "a contract made in the State of New York and governed by the laws thereof"; (3) Discussions concerning performance took place in New York; (4) A supplemental contract was executed in New York; and (5) The machines were delivered to the plaintiff's plant in New York and were there installed and tested over a period of three months by the defendant's top engineers. The New York Court of Appeals concluded, in view of this overwhelming factual proof, that the defendant was subject to the *in personam* jurisdiction of the New York Courts.

In one tort action, *Feathers* v. *McLucas,* a steel tank, defectively manufactured by the defendant in Kansas, was eventually sold to a Pennsylvania corporation and exploded in New York, injuring the plaintiff. The Court held that the defendant manufacturer was *not* subject to the *in personam* jurisdiction of the New York Courts.

In the second tort action, *Singer* v. *Walker,* a geologist's hammer manufactured in Illinois was sold by the Illinois manufacturer to a dealer in New York. The hammer pur-

chased from the dealer in New York split when used in Connecticut, injuring the plaintiff. The *in personam* jurisdiction of the New York Courts was sustained, not because of the single transaction described, but only because the Illinois manufacturer "had shipped substantial quantities of its products into this state as the result of solicitation here through a local manufacturer's representative and through catalogues and advertisements" (p. 466). As a result, the Court held that the defendant was actually engaged in the general transaction of business within the State of New York (p. 467).

Union attempts to distinguish *Boas* v. *Vernier*, 22 A. D. (2d) 561, upon the ground that the defendant in that case did not perform any act "with respect to the oral agreement in New York". What Union has completely overlooked, however, is that the plaintiff was originally employed under a written agreement delivered and executed in New York. The written agreement was subsequently superseded by an oral agreement in France. Necessarily, then, the plaintiff surrendered his New York rights under the New York contract. The New York Court squarely held that the execution of the New York contract, and the extinguishment of the plaintiff's rights thereunder upon the consummation of the oral contract, did not subject the defendant to the *in personam* jurisdiction of the New York Courts in a suit upon the superseding oral contract concluded in France. The decision is controlling and dispositive, particularly in its emphasis upon the fact, so apposite herein, that: "The fact that a prior written agreement was historically necessary to the inception of the subsequent oral agreement does not alone, for purposes of the jurisdiction statute support personal jurisdiction" (p. 563).

4. Union has referred (p. 7) to Dragor's refusal to appear for the trial of its counterclaim which was then dismissed for lack of prosecution. Although that matter has no conceivable relevancy to the issues presented by this appeal, it is important, in view of Union's reference, that the Court be fully apprised of the pertinent facts.

From the very institution of this lawsuit, Dragor has vehemently contested the *in personam* jurisdiction of the District Court. After its motion to quash was denied, it moved, under 28 U. S. C. A., §1292, subs. (b), for leave to appeal to this Court. The District Court denied that motion, in spite of Dragor's concern that its right to contest the *in personam* jurisdiction of the District Court might be jeopardized if it were compelled, involuntarily, to interpose a compulsory counterclaim in this action. At that time, Union insisted that the forced interposition of a compulsory counterclaim could not possibly jeopardize Dragor's right to challenge the *in personam* jurisdiction of the District Court. Still concerned, Dragor sought a writ of prohibition from this Court. Union repeated its arguments below, that Dragor could not possibly jeopardize its jurisdictional objection by the involuntary interposition of a compulsory counterclaim. The application for a writ was thereupon denied.

Subsequently, Union brought an action in the Connecticut District Court against Isbrandtsen upon his guarantee; Isbrandtsen claimed over against Dragor; and Dragor filed its counterclaim against Union.

Since all three parties—Union, Dragor and Isbrandtsen—were properly before the Connecticut District Court, and there was no cloud upon its jurisdiction, Dragor thereupon moved in this action, under Rule 41(a)(2) of the Federal Rules, for leave to discontinue the counterclaim without prejudice (since the judgment appealed from herein had already been entered by the District Court) upon the ground, among other things, that the jurisdiction of the District Court was the subject of this appeal pending in this Court, and that, should Dragor's position upon its appeal be sustained, all of the proceedings in the District Court would be annulled, resulting in an intolerable waste of time and effort and an enormous expense to Dragor. Before the argument for leave to discontinue was even commenced, the District Court announced that, even

if this Court reversed the judgment appealed from herein, Dragor's involuntary interposition of a compulsory counterclaim had conferred upon it, and it intended to exercise, jurisdiction to try the same. In view of the directly contrary arguments and rulings preceding the interposition of the counterclaim, the Court's announcement came as a shock to Dragor. The District Court denied Dragor's motion for leave to discontinue without prejudice.

As a result, Dragor became convinced that any further participation by it in the proceedings before the District Court might impair its claim that the District Court never acquired jurisdiction over the person of Dragor either by the service of process or by its involuntary interposition of a compulsory counterclaim. Consequently, it refused to proceed any further, confident that its position would be sustained upon appeal. An appeal has been taken from the District Court's action in dismissing the counterclaim with prejudice and will be heard by this Court in due course.

5. We are told by Union (p. 24) that "even if only a single transaction was here involved", the decisions which Dragor has cited herein, both of the United States Supreme Court and this Court, are distinguishable because the corporations involved (in those cases) had never been licensed in the forum state. In essence, then, it is Union's position that, once a corporation has been qualified to do business in a foreign state, and thereafter formally withdraws from that state in accordance with its laws, it is nevertheless forever subject to the *in personam* jurisdiction of that state, even if it never afterwards performs a single act which possesses, in the language of this Court in *L. D. Reeder, supra,* "a double substantial connection" with such state. The argument is totally fallacious. It has been rejected out-of-hand by innumerable decisions. (*Confidential, Inc.* v. *Superior Court,* 157 Cal. App. (2nd) 75, 320 Pac. (2nd) 546; *Hexter* v. *Day-Elder Motors Corp.,* 192 App. Div. 394, 182 N. Y. Supp. 717).

CONCLUSION

Because of the immense importance of this case to Dragor and its several thousand public stockholders throughout the United States, we have sought to analyze, with great care, every argument and decision advanced by Union upon this appeal, an analysis which we are convinced has established a total lack of any basis whatsoever for the attempted assumption of *in personam* jurisdiction by the Court below. Unless this Court is prepared to eliminate the due process mandate of the Constitution in its entirety, and substitute therefor the pot pourri of factual and legal misstatements and litigious animus offered by Union herein, the judgment of the District Court must be reversed. The words of Judge Sobeloff sound a warning which cannot be ignored:

> "If jurisdiction were sustained on such slight strands the maze of interstate lawsuits growing out of the heavy volume of interstate commerce in this country could bring intolerable turmoil to the administration of justice". (Sobeloff, Non-Residence In Our Federal System, 43 Cornell Law Quarterly, 196, 205).

It is respectfully submitted that the judgment appealed from be reversed, the plaintiff's complaint dismissed, and all proceedings had in this cause before the District Court of Arizona annulled in all respects.

Respectfully submitted,

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Certificate of Compliance

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JOSEPH LOTTERMAN
Attorney

IN THE

United States Court of Appeals

FOR THE

NINTH CIRCUIT

DRAGOR SHIPPING CORPORATION,
formerly Ward Industries
Corporation,

Appellant,

vs.

NO. 20416

UNION TANK CAR COMPANY, a
corporation,

Apellee.

PETITION FOR REHEARING

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The appellee respectfully petitions the Court for a rehearing on the grounds hereinafter set forth.

I

The factual errors permeating the delivered opinion apparently stem from the Court's reliance on the false and misleading statements appearing in an uncorroborated affidavit of a Mr. Weiser, counsel for Dragor (R. 17).

> The delivered opinion of this Court asserts that: "The stipulations dismissing the two Arizona suits, called for by the settlement agreement, were executed in New York and thereafter filed in Arizona."

The truth is that while the settlement agreement and promissory note were executed by Dragor in New York on October 3, 1963, concurrently therewith the stipulation of dismissal were prepared by counsel for Dragor in Phoenix, Arizona, executed by Arizona counsel for the parties, and tendered to Judge Walsh on October 3, 1963, and an order was entered at Tucson, Arizona, on that same day, dismissing the cases. Certified copies of these orders are filed herewith.

It is thus seen that the intention of the parties in providing for delivery of stipulations of dismissal was to effectuate the dismissal with prejudice of both actions, simultaneously with and as an integral part of the settlement agreement. This completely removes the foundation for the language in the delivered opinion that:

> "The stipulations dismissing the Arizona suits *were executed in New York* but filed in Arizona. Such filing was long prior to Sep-

> tember 30, 1964, when, Union asserts, Dragor committed the breaches sued upon. The filing of these dismissals constitutes an isolated inconsequential act having no legal significance in this law suit." (Emphasis added)

The delivered opinion contains a further misstatement, again apparently based upon the Weiser affidavit:

> "No contention raised in Union's complaint or Dragor's answer brings into question any issue of fact or law pertaining to the former dealings between these parties in Arizona."

It is apparent that the set-off and counter claim filed as part of the answer does bring into question issues of fact pertaining to the former dealings between these parties in Arizona. Prior transactions between these parties involved the construction of missile bases in Tucson, Arizona, in the course of which Union and Dragor acquired claims against the government and Fluor, the prime contractor, arising out of the missile base contract. The settlement agreement expressly provides for the prosecution by Union of claim "arising out of the Titan II Davis-Monthan Air Force Base Contract No. DA-04-548-ENG-42, whether such sums sholl arise from Claim of Union, IMI-WARD . . . or otherwise . . ." (R. 100)

The counter claim charges that Union changed, altered, and dilatorily, inefficiently, and negligently asserted such claims for work done by the parties in Tucson, Arizona, so as to damage Dragor in a sum not less than a million dollars (R. 102-104). Clearly the counterclaim "brings into question" an issue of fact "pertaining to the former dealings between these parties in Arizona." The allegation that the claims were mishandled and misasserted will of necessity

require evidence as to proper performance of the work in Arizona, the cost of such work, the contractual relations between all of the parties to such work, and other pertinent factors in order to determine the nature of the claims and whether they have been competently and diligently asserted. The former dealings between the parties in Arizona are of prime importance in making these determinations.

The alleged breach of the covenant not to sue —asserted in the counterclaim was alleged to have occurred in Arizona during the trial of an action pending in Arizona, and the facts forming a basis for determining whether or not the breach occurred were to be found solely and exclusively in the records of an Arizona court. Moreover, the issue could be best determined by Judge Walsh who had heard all aspects of the Arizona controversy.

Moreover, Dragor asserts that its counterclaim arises out of the same transaction as the settlement contract sued on and therefore is a compulsory counterclaim (R. 105). If so, under this Court's decision that Union must sue in New York or Delaware, then the counterclaim must be litigated in a court far distant from the place where the work was done.

Judge Walsh was thoroughly familiar with the litigation involving the missile base contracts.[1] He had a right to ignore the uncorroborated Weiser affidavit as false. It was therefore the duty of the appellant to file a record sufficient to demonstrate whether or

[1] The District Court could take judicial notice of these other actions as they were referred to in the pleadings in this cause and represent related litigation. *Lowe v. McDonald,* 221 F.2d 228 (9th Cir. 1955); *Freshman v. Atkins,* 46 S. Ct. 41, 269 U.S. 121, 70 L. Ed. 193 (1925). And this Court will take judicial notice thereof, the District Court having done so. *Kalimin v. Liberty Mutual Fire Insurance Co.,* 300 F.2d 547 (2nd Cir., 1962).

not the District Court erred in so holding under penalty of dismissal of the appeal *T. V. T. Corp. vs. Basiliko,* 257 F. 2nd 185 (D. C. 1958). Dragor had full knowledge of the related litigation and should have brought the original records thereof to this Court or at least given an accurate account thereof. It's factual inaccuracies should not be permitted to succeed in leading this Court into error even though discovered on rehearing. *American Chemical Paint Co. v. Dow Chemical Co.*, 164 F 2nd 208 (6th Cir., 1947).

II

The District Court, in upholding jurisdiction, found as a fact that the contractural obligations asserted in the complaint and counterclaim were contracts "involving business done . . . in Arizona." Judge Walsh was familiar with the multi-million dollar missile base contracts, their performance by the various parties, the litigation and settlement, and the entire background of the controversy. His finding that these contracts were contracts "involving business done" by Dragor in Arizona should not be disregarded by this Court as though it were free to determine factual issues *de novo.*

III

The Court erred in holding, in effect, that the mere fact that the settlement agreement and note were executed in New York makes this transaction between the parties exclusively a New York transaction. The fact that the instruments were signed in New York by Dragor is purely fortuitous, resulting from the fact that Isbrandtsen, the surety, (R. 8) was in New York, and Union required his guarantee as part of the transaction. Nothing in the record shows that the parties intended the transaction to be a New York transaction.[2] Union had no connection

with New York, and Union was in full control of the settlement. Dragor was in stringent financial condition (R. 83), was being forced to trial on Union's action, and did not dare bring on its own suit against Union because that action was totally without merit.

[2] The Agreement and note contain no reference whatsoever to New York, and the note by its terms is to be construed according to Illinois law (R.5).

IV

This court also erroneously assumes that because Dragor gave Union a promissory note, executed in New York, that thereby Dragor ceased to be a debtor and that Union was no longer a creditor. The settlement papers provide that the note was to be construed in accord with Illinois law (R. 11). That Union was a creditor under Illinois law is shown by the case of *Superior Plating Co. v. Art Metals Crafts Co.,* 218 Ill. App. 148, 150.

This Court has further overlooked the fact that Dragor had appointed C. T. Corporation as its agent for the acceptance of service of process and that such appointment had never been revoked either by any act of Dragor's or by any act of the State of Arizona, because the permission granted Dragor to withdraw from Arizona excepted from its terms Dragor's creditors.[3]

[3] "Defendant further argues that since process was not served until some nine months after defendant's activities in the state ceased, the defendant was not doing business in Iowa at the time of service of notice and that service could not be made upon it in June of 1953. This contention is not sound. A foreign corporation which has ceased to do business in a state is still subject to service of process in suits on causes of action which arose out of business carried on by the defendant in the state. 20 C. J. S., Corporatioons, S 1920, p. 170; Zendle v. Garfield, 29 F 2d 415; Kelly v. Johnson Nut Co., 38 F. 2d 177; Elk River Coal & Lumber Co. v. Funk, 222 Iowa 1222, 110 A. L. R. 1415."

CONCLUSION

We respectfully suggest that this Court has departed from its proper function as a reviewing court and has attempted to deal with factual situations *de novo* without having before it the entire record. We further suggest that, because of the importance of the legal precedent here involved, this matter should be reheard by this Court, and the Court should defer a final decision in this case until it has had an opportunity to examine the entire record which will be presented to this Court in the appeal from the judgment entered against Dragor on the counterclaim.

We submit, therefore, that this Court, for reasons set forth above, should either grant a rehearing in the instant case, or take the petition for rehearing under advisement and reserve a decision thereon until after a hearing has been had on the appeal from the judgment entered against Dragor on the counterclaim.

Respectfully submitted,
THOMAS C. McCONNELL
BOYLE, BILBY, THOMPSON &
SHOENHAIR

By H. C. Warnock

Attorneys for Appellee
Ninth Floor Valley National Bldg.
Tucson, Arizona

CERTIFIED

I hereby certify that in my judgment the foregoing motion for rehearing is well founded, and that it is not interposed for delay.

HAROLD C. WARNOCK
Counsel for Appellee

FOLDOUT BLANK

OCT 3 1963

1:40 p.m.

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

UNION TANK CAR COMPANY,

Plaintiff,

v.

WARD INDUSTRIES CORPORATION,

Defendant.

No. Civ. 1482-Tuc.

STIPULATION AND ORDER FOR DISMISSAL

STIPULATION

IT IS HEREBY STIPULATED AND AGREED, by and between the parties hereto, that the above-entitled action, including the Complaint and Counterclaim, be dismissed and discontinued with prejudice and without costs to either party against the other, and that an Order to such effect may be entered without notice to either party.

Dated this 3rd day of October, 1963.

THOMAS C. McCONNELL
BOYLE, BILBY, THOMPSON & SHOENHAIR

By _____
Attorneys for Plaintiff

LOTTERMAN & WEISER
EVANS, KITCHEL & JENCKES

By _____
Attorneys for Defendant

O R D E R

Pursuant to the foregoing Stipulation, IT IS HEREBY ORDERED, that the above-entitled action, including the Complaint and Counterclaim, be and the same is hereby dismissed with prejudice and without costs to either party against the other.

Done in Open Court this 3rd day of October, 1963.

_____
United States District Judge

EVANS, KITCHEL & JENCKES
363 NORTH FIRST AVENUE
PHOENIX, ARIZONA

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF ARIZONA

WARD INDUSTRIES CORPORATION,

Plaintiff,

v.

UNION TANK CAR COMPANY and IDAHO MARYLAND INDUSTRIES, INC.,

Defendants.

No. Civ. 1478-Tuc.

STIPULATION AND ORDER FOR DISMISSAL

STIPULATION

IT IS HEREBY STIPULATED AND AGREED, by and between the parties hereto, that the above-entitled action be dismissed and discontinued with prejudice and without costs to either party against the other, and that an Order to such effect may be entered without notice to either party.

Dated this 3rd day of October, 1963.

LOTTERMAN & WEISER
EVANS, KITCHEL & JENCKES

By _____
Attorneys for Plaintiff

THOMAS C. McCONNELL
BOYLE, BILBY, THOMPSON & SHOENHAIR

By _____
Attorneys for Defendant UNION TANK CAR COMPANY

O R D E R

Pursuant to the foregoing Stipulation, IT IS HEREBY ORDERED, that the above-entitled action be and the same is hereby dismissed with prejudice and without costs to either party against the other.

Done in Open Court this 3rd day of October, 1963.

_____
United States District Judge

EVANS, KITCHEL & JENCKES
363 NORTH FIRST AVENUE
PHOENIX, ARIZONA

No. 20418

United States
COURT OF APPEALS
for the Ninth Circuit

CONTINENTAL CASUALTY COMPANY,
a corporation,

Appellant,

v..

JUSTIN N. REINHARDT, SEYMOUR L. COBLENS, NORMAN A. STOLL and MORTON A. WINKEL,

Appellees.

APPELLANT'S OPENING BRIEF

Appeal from the United States District Court for the District of Oregon

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v..

JUSTIN N. REINHARDT, SEYMOUR L. COBLENS, NORMAN A. STOLL and MORTON A. WINKEL,

Appellees.

APPELLANT'S OPENING BRIEF

Appeal from the United States District Court for the District of Oregon

STATEMENT OF JURISDICTION

This is an appeal from a final order of the United States District Court for the District of Oregon. It is an action by appellant for a declaratory judgment under the provisions of the Federal Declaratory Judgment Act, 28 U.S.C. Sec. 2201. Appellant issued a policy of professional liability insurance to appellees, attorneys at law practicing in Portland, Oregon. Appellees, having been

sued by a third party in the Circuit Court of the State of Oregon, demanded that appellant defend them. Appellant seeks a declaratory judgment that it is not obligated to defend the third party's state court action.

The appellant is a corporation organized and existing under and by virtue of the laws of the State of Illinois and is authorized to engage in the insurance business in the State of Oregon. It has no principal place of business within the State of Oregon. The appellees are individual attorneys, residents of the State of Oregon, members of the Oregon State Bar, and authorized to engage in the practice of law within the State of Oregon. The amount in controversy, exclusive of interest and costs, exceeds the sum of $10,000 and the Court below assumes jurisdiction by reason of diversity of citizenship and appellate jurisdiction is granted this court by Title 28, § 1291 U.S.C.A.

STATEMENT OF THE CASE

The case was tried before the District Court without a jury on the pretrial order. The trial was limited to the single issue of whether the plaintiff was obligated to defend any or all of the defendants in the action entited "*Fordham* v. *Reinhardt, et al*" in the Multnomah County State Court. The only evidence presented at the time of trial was the insurance policy issued by appellant to appellees, a copy of the complaint filed in the State Court against the appellees, a motion against the complaint filed by the appellees, and a copy of the order on

the hearing of the motion (Op. 3-4). The District Court opinion held that appellant was obligated to defend the appellees; this judgment is challenged by this appeal.

Appellant issued a lawyers' professional liability policy to appellees providing, *inter alia*:

> "To pay on behalf of the insured all sums which the insured shall become obligated to pay by reason of the liability imposed upon him by law for damages resulting from any claim made against the insured arising out of the performance of professional services for others in the insured's capacity as a lawyer or a notary public and caused by any act, error or omission of the insured or any other person for whose acts the insured is legally liable."

Exclusion (a) provides the policy is not applicable to:

> "* * * Any dishonest, fraudulent, criminal or malicious act or omission of the insured, any partner or employee; * * *."

Appellees Reinhardt, Coblens and Stoll are partners engaged in the practice of law in the State of Oregon. Subsequent to the issuance of appellant's policy, the defendant Mr. Morton Winkel (hereinafter referred to as "Winkel") was included as a named insured. Winkel and the defendant firm represented Mansfield & Company (hereinafter referred to as "Mansfield") a creditor of Metropolitan Materials Company (hereinafter referred to as "Metropolitan"). Since Metropolitan was insolvent, appellees were unable to collect a judgment against Metropolitan, due and owing to Mansfield.

Mr. Kalkhoven and Mr. Fordham were the princi-

pals of Metropolitan; Mr. Fordham was a certified public accountant. Winkel threatened to bring an action against Fordham and Kalkhoven individually upon the theory that they misrepresented the financial status of Metropolitan and, relying upon this representation, Mansfield was induced to extend credit to its detriment. Winkel further threatened to send a copy of the complaint to the State Board of Accountancy.

When Fordham refused to assume personal liability for Metropolitan's debt, Winkel made good his threat and filed an action on behalf of Mansfield against Fordham and Kalkhoven in Multnomah County Circuit Court. Three causes of action were stated. First, that financial statements made by Fordham in connection with the extension of credit to Metropolitan, and upon which Mansfield relied in selling insurance to Metropolitan, were false, were known to be false when prepared, and were presented to Mansfield to induce it to extend credit. Second, that Fordham was liable as a director of Metropolitan for operating with insufficient capital, which insufficiency jeopardized Metropolitan's contractual obligations to the prejudice of creditors. Third, that the transfers of certain Metropolitan assets by the principals, including Fordham, were intended to hinder, delay and defraud creditors of Metropolitan, including Mansfield. Making good the second portion of his threat, Winkel forwarded a copy of the complaint, with cover letter, to the State Board of Accountancy.

The Circuit Court of the State of Oregon held in favor of Fordham and his associates on the theory that

there was no intent to defraud and no reliance by Mansfield upon the representations (Op. 3).

Fordham then filed, in the Multnomah County Circuit Court, an action for trade libel against the appellees, alleging in part:

> "That the sending of a copy of the Summons and Complaint to the State Board of Accountancy and the publication of the Summons and Complaint thereby effected was a trade and professional libel; that said action was taken strictly as what is commonly termed 'blackmail' in an effort to induce payment by the plaintiff herein of sums which were not owed by him; that despite cautioning and requests by attorney John Faust, Jr. that said action not be taken, the same action was nevertheless taken with a malicious motive and solely for the purpose of attempting to blackmail the plaintiff herein and for the sake of humiliating and embarrassing the defendant [sic] before his professional licensing board within this state, there being no other possible motive for the publication of said Summons and Complaint to the said State Board of Accountancy and its presentation to the Executive Secretary and members of said Board."

Motions were interposed on behalf of the appellees, some of which were allowed. At the time of trial of the instant action, no amended complaint had been filed in conformance with the order of the circuit court.

Appellees contend that appellant, under its aforementioned policy, had a duty to defend the action instituted by Fordham. Appellant sought a declaratory judgment that no duty to defend existed. The district court decided

only this single issue; it held that the appellant was bound to defend the appellees on the theory that the allegations of the Fordham complaint were "sufficiently ambiguous to permit the advancement of many theories of liability" (Op. 4). Appellants bring this appeal.

SPECIFICATIONS OF ERROR

1. The district court erred in finding and concluding that the plaintiff was bound to defend the action filed against the defendants in the Circuit Court of the State of Oregon for the County of Multnomah by Leslie E. Fordham.

2. The district court erred in entering its order requiring plaintiff to defend the defendants in the state court action entitled "Leslie E. Fordham v. Reinhardt, et al" pending in Multnomah county, being Clerk's Registry No. 303-532.

3. The court erred in finding and concluding that the allegations of the Leslie E. Fordham complaint against the defendants were sufficiently ambiguous to present the advancement of many theories of liability and that the allegations of the complaint stated a cause of action within the coverage of the policy issued by the plaintiff to the defendants requiring the plaintiff to defend the action.

4. The court erred in failing to find and conclude the allegations of the Fordham complaint against the defendants clearly stated a cause of action within the policy coverage, and that plaintiff was not required to afford a defense to the defendants in the Fordham action.

5. Each of the above mentioned findings made and entered by the District Court are clearly erroneous.

6.. Each of the above mentioned conclusions of the district court are contrary to the evidence and the law.

SUMMARY OF ARGUMENTS

The duty to defend is measured by the face of the complaint filed against the insured. The Fordham complaint showed no claim stated potentially within the policy coverage; there was no ambiguity which would permit the inference of a claim covered by the policy. The Fordham complaint alleged conduct on the part of the assured which was excluded as "malicious." The Fordham complaint further alleged acts which did not constitute conduct within the assured's professional capacity as a lawyer.

ARGUMENT

1. The insurer's duty to defend is measured by the allegations of the complaint filed against the assured.

The duty to defend is not dependent upon the merits of the case, since an insurer is obligated to defend suits *within the policy coverage* even if the same are false, fraudulent or groundless. See *MacDonald* v. *United Pacific Insurance Co.*, 210 Or. 395, 399, 311 P.2d 425 (1957). The determination of the existence of a duty to defend must be made upon a comparison of the allegations of the complaint filed against the insured and the coverage of the policy issued to the insured. See *Isenhart* v. *Gen-*

eral Casualty Co., 233 Or. 49, 377 P.2d 26 (1962). A comparison of the pleadings in the case filed by Fordham against the appellees and the policy issued by appellant, particularly the provisions and exclusions quoted hereinbefore, make it clear that no duty to defend arose because the complaint presented a claim excluded by the policy. The policy covered activities of the insured while acting in his professional capacity of a lawyer or notary public; it specifically excluded malicious acts. The Fordham complaint alleged conduct not within the capacity as a lawyer and conduct which was malicious. Therefore, the complaint stated no claim potentially within the coverage of the policy.

The governing substantive of law is that of the state of Oregon. The Oregon court has recently affirmed its adherence to the general rule that an insurer's duty to defend is measured solely by the allegations of the complaint filed against its insured. In *Isenhart* v. *General Casualty Co.,* supra, 233 Or. 54, the Oregon Supreme Court stated:

* * * * *

> "There is some authority for the view that in determining whether it has a duty to defend the insurer must look beyond the allegations of the complaint filed against the insured and if the actual facts are such as to bring the case within the coverage of the policy, the insurer must accept the tender of defense. The contrary view has been adopted in this state. In accordance with the weight of authority, we have held that the obligation of the insurer to defend is to be determined by the allegations of the complaint filed against the insured.

> "We adhere to this view. The insurer contracts to indemnify the insured within certain limits stated in the policy. If the facts alleged in the complaint against the insured do not fall within the coverage of the policy, the insurer should not have the obligation to defend. If a contrary rule were adopted, requiring the insurer to take note of facts other than those alleged, the insurer frequently would be required to speculate upon whether the facts alleged could be proved. We do not think that this is a reasonable interpretation of the bargain to defend. It is more reasonable to assume that the parties bargained for the insurer's participation in the lawsuit only if the action brought by the third party, if successful, would impose liability upon the insurer to indemnify the insured."

For other decisions asserting the same rule, see *MacDonald* v. *United Pacific Insurance Co.,* supra; 50 A.L.R.2d, Annot.: "Allegations in third persons' action against insured as determining liability insurer's duty to defend" 458-512 (1956), relied upon by the Oregon Supreme Court in *MacDonald,* supra; *Blohm et al* v. *Glens Falls Insurance Co.,* 231 Or. 410, 417-418, 373 P.2d 412 (1962); *Jarvis et ux* v. *Indemnity Insurance Co.,* 227 Or. 508, 517, 363 P.2d 740 (1961). See also, *Journal Publishing Co.* v. *General Casualty Co.,* 210 F.2d 202, 208 (9th Cir. 1954) indicating that the duty to defend and the duty to indemnify are premised upon different considerations.

Oregon's adherence to the rule is clear. The reasons for the rule, some of which are asserted in the foregoing paragraphs from *Isenhart,* require no elaboration on the

part of appellant. The complaint filed by Fordham against the appellees fail to state a claim potentially within the coverage of the policy, and the appellant had no duty to defend.

2. The Fordham complaint alleged an excluded claim and appellant had no duty to defend.

The district court held that appellant had a duty to defend appellees in the Fordham action. The apparent basis of the Court's holding was that "the allegations in the circuit court complaint are sufficiently ambiguous to permit the advancement of many theories of liability" (Op. 4). Appellant asserts that this was clearly erroneous. A comparison of the Fordham complaint and the appellant's policy reveals that the claim is excluded. The conduct of Winkel was alleged to be malicious. The acts of Winkel did not constitute conduct of a lawyer in his professional capacity. The theory of recovery was clearly delineated in the Fordham complaint; it was not ambiguous and no theory of recovery alleged would bring the claim within the potential policy coverage.

The insurer's duty to defend is limited to those causes potentially within the policy coverage. If a cause is stated potentially within the policy coverage, then the insurer is obligated to defend, regardless of whether the claim is false, fraudulent or groundless. The converse is also true; a valid claim need not be defended if, on the face of the complaint, no claim within the policy coverage is stated. The duties of defense and indemnity are distinct.

(A) *The appellees conduct was malicious, and was excluded from coverage by the policy.*

The district court's ruling that appellant had a duty to defend appellees was clearly erroneous since the Fordham complaint alleged conduct which was "malicious" and hence excluded under exclusion (a).

Appellant has been unable to discover a factually apposite case involving a lawyer's professional liability policy. The Fordham complaint alleged a cause of action for trade libel; paragraph XIV alleged that the sending of the complaint to the State Board of Accountancy was done for the purpose of "blackmail" and with a "malicious motive." Exclusion (a) provided that the policy was inapplicable to "any dishonest, fraudulent, criminal or malicious act." On this comparison of the complaint and the policy, then, no claim was stated potentially within the policy coverage.

Appellees contended in the district court that this exclusion applied only to "actual malice" existing in the mind of the insured and then only excluded indemnity; further, it was contended that "malice" was an ambiguous term, having at least two meanings in defamation cases.

First, there is nothing in law or fact to warrant the assertion that the "malice" exclusion applies only to the duty to indemnify.

Second, "malice" in common parlance means ill will against a person, but legally the Oregon Supreme Court has said it means wrongful acts intentionally done with-

out just cause or excuse. *Jaco* v. *Baker,* 174 Or. 191, 148 P.2d 938 (1944). "Malicious" means to harbor malice, ill will or enmity, or to have a bent to do evil or a deliberate intent to injure another. *Cook* v. *Kinzua Pine Mills Co., Inc.,* 207 Or. 34, 293 P.2d 717 (1956).

Third, since malicious acts are excluded, the appellant is not bound to search behind the face of the Fordham complaint in order to determine what meaning or meanings were attached to the word "malicious." Malicious acts are excluded from coverage; the complaint alleges a malicious tort; therefore, there is no duty to defend. If appellant were required to investigate the meaning attached to verbiage in the complaint, the force of the *Isenhart* rule, supra, would be destroyed or circumvented.

A somewhat analogous case involving a druggist's liability policy is *Hewit Pharmacy* v. *Aetna Life Insurance Co.,* 267 N.Y. 31, 195 N.E. 673 (1935). The policy provided for indemnity for damages resulting from death or bodily injury accidentally suffered in consequence of any "error or mistake" during the policy period arising out of "preparing, compounding, dispensing, selling or delivering at or from the premises" any "drugs, medicines or merchandise customarily kept for sale in drug stores." There was a policy exclusion for injuries or death caused by employees in violation of law or caused by failure to comply with any statute or local ordinance or in consequence of any unlawful act.

The insured operated both at retail and wholesale. One of its clerks, by mistake and without any intent to

violate the law, failed to label a certain drug which she believed was being sold at wholesale (where labelling was not required) when in fact it was being sold at retail (where labelling was required). As a result, the purchaser's wife drank the poison and died. The court held that the selling of the product without the label was an unlawful act committed by an employee of the insured and, therefore, came directly within the exclusion.

The cases would indicate that a communication of the complaint to the State Board of Accountancy might be subject to a qualified privilege, whether done by Winkel in his individual capacity or his capacity as a lawyer. However, the conduct is still actionable, despite the qualified privilege, if the act were maliciously done. Therefore, since the policy excludes malicious acts, and since the only unprivileged basis for the claim would be a malicious act, the conduct was excluded and appellants had no duty to defend.

Appellants respectfully submit that the act charged was malicious, that the policy excluded malicious acts, and therefore the appellant had no duty to defend.

(B) *The conduct of Winkel was not an "act arising out of the performance of professional services for others in the assured's capacity as a lawyer."*

The foregoing effectively shows that the ruling of the district court was clearly erroneous. The court reserved consideration of evidence and ruling upon appellants' further contention that the appellees' acts did not constitute conduct as a lawyer. However, appellant con-

tends that on the face of the complaint it is apparent that Mr. Winkel was not acting in his capacity as a lawyer at the time of the alleged tort.

Lawyers' professional liability policies seldom have been discussed by the courts. The few decisions rendered do not seem apposite to the issues raised herein. See generally, 72 A.L.R.2d Annot., "Coverage, and exclusions, of liability or indemnity policy on attorney at law," 1249-1251 (1960).

American Fire and Casualty Co. v. *Kaplan,* 183 A.2d 914 (Mun. Ct. D.C. 1962) involved a negligent doing of an act which was clearly within one's professional capacity as a lawyer. *Strauss* v. *New Amsterdam Casualty Co.,* 216 N.Y. Supp. 2d 861, 30 Misc. 2d 345 (1961) involved a policy worded differently from that issued by appellant; the New York court held that an action for money had and received was not encompassed by a "malpractice, error or mistake" policy. *Cadwallader* v. *New Amsterdam Casualty Co.,* 396 Penn. 582, 152 A.2d 484 (1959) involved a negligent act, error or omission which was clearly conduct within the assured's capacity as a lawyer.

Lacking controlling authority, the issue must be determined by an examination of the policy language, the conduct of Winkel, basic legal principles, and pertinent analogies.

The policy provided coverage for claims:

> "* * * made against the insured arising out of the performance of professional services for others

> in the insured's capacity as a lawyer * * * caused by any act, error or omission of the insured * * *."

The obvious purpose of the clause is to limit the insurer's liability to conduct of the insured as a lawyer. The insurer is entitled to limit its obligations by appropriate language and the court will not rewrite the policy where this has clearly been done.

Appellant contends that the conduct of Winkel charged in the Fordham complaint was not action as a lawyer. The complaint charges Winkel with a trade or professional libel by means of a specific act: mailing a copy of the complaint to the State Board of Accountancy. The filing of a complaint on behalf of a client is not the challenged act.

While pleadings filed in an action or suit are public records, the transmission of a copy of a filed pleading, with or without comment, may constitute defamation; that is precisely the only theory possible on the face of the Fordham complaint. Several cases involving professional liability policies have considered analogous issues.

In *Kime* v. *Aetna Casualty & Surety Co.*, 66 Ohio App. 277, 33 N.E.2d 1008 (1940), it was held that an indemnity policy insuring an optometrist against damages resulting from loss or expense on account of malpractice, error or mistake in the practice of optometry did not cover the malpractice of an optometrist in doing things not covered by the statutory definition of optometry. Thus, the removal by the optometrist of certain particles from a patient's eyes by objective means was not the practice of

optometry as defined by the statute and the insurance company was not liable under its policy for injury to the patient's sight.

In *Crenshaw* v. *United States Fidelity & Guaranty Co.,* 193 S.W.2d 343 (Mo. 1946), the defendant insured the plaintiff "for professional services rendered * * * and resulting from any claim or suit based upon malpractice, error, negligence or mistake, breach of implied contract, loss of service, property damage, autopsies, inquests, personal restraints, the dispensing of drugs or medicine, assault, slander, libel * * *."

The decedent's wife filed an action against the insured for an unlawful autopsy performed upon the body of her husband. The basis of the cause of action was that the insured, as county coroner, permitted local university medical students to perform the autopsy. The insurer refused to defend, and when a judgment was had against the insured, the judgment creditor guarnisheed the insurance company. The court held that the insurance company had no coverage because its liability was restricted to acts performed in the insured's professional capacity as a physician and surgeon, and did not extend to acts performed in his official capacity as coroner.

In *Glesby* v. *Hartford Accident & Indemnity Co.,* 6 Cal. App 2d 89, 44 P.2d 365 (1935) an injury occurred to a patient resulting from treatment by an osteopathic physician's unlicensed assistant knowingly permitted by the physician. The California court held that the claim was not covered by the liability policy issued to the physician which excluded injuries caused while engaged in performing an unlawful act.

In order to justify the challenged conduct, appellees must indicate that, in some manner, the gratuitous mailing of the complaint to the State Board of Accountancy was the performance of a professional service. Appellant is unable to apprehend how this could be. How would the forwarding of a complaint to the State Board of Accountancy aid in the collection of a debt for appellee's client within the scope of conduct authorized by the canons of professional ethics? If a formal complaint were to be made to the professional board, regarding the conduct of Mr. Fordham, should not this complaint be made by the party injured (and presumably in possession of the facts) and not his attorney? If a complaint were to be made, why wasn't it done by normal channels, instead of mailing a copy of a pleading?

(C) *The Fordham complaint was not "sufficiently ambiguous as to allow recovery on many theories of liability."*

What the district court apparently held was that the Fordham complaint was sufficient to support several theories of recovery, some of which would be covered by appellant's policy. With this statement, appellants disagree.

The complaint sounded in trade libel; it was so labeled and pleaded. Appellant is unable to conjure up any theory of recovery not excluded by the policy. The complaint was hardly ambiguous. It set forth facts substantially as outlined in this brief, supra. Since the district court did not favor the parties with examples to support its statement, appellant can only conclude that it had no examples and appellant is unable to provide any.

CONCLUSION

The district court ruling that appellant had a duty to defend appellees in the Fordham action was clearly erroneous and should be reversed. The Fordham complaint alleged a malicious tort and exclusion (a) excluded malicious acts from coverage. Moreover, the Fordham complaint disclosed conduct on the part of the insured which was not conduct as a lawyer performing professional services. The ruling of the district court has no basis in law or fact.

Respectfully submitted,

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Attorneys for Appellant

CERTIFICATE OF COUNSEL

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

KENNETH E. ROBERTS
Of Attorneys for Appellants

No. 20418

United States
COURT OF APPEALS
for the Ninth Circuit

CONTINENTAL CASUALTY COMPANY,
a corporation,

Appellant,

v.

JUSTIN N. REINHARDT, SEYMOUR L. COBLENS, NORMAN A. STOLL and MORTON A. WINKEL,

Appellees.

APPELLEES' ANSWERING BRIEF

Appeal from the United States District Court for the District of Oregon

HON. JOHN F. KILKENNY, Judge

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STEVENS-NESS LAW PUB. CO., PORTLAND, ORE. 12-65

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No. 20418

United States
COURT OF APPEALS
for the Ninth Circuit

CONTINENTAL CASUALTY COMPANY,
a corporation,

Appellant,

v.

JUSTIN N. REINHARDT, SEYMOUR L. COBLENS, NORMAN A. STOLL and MORTON A. WINKEL,

Appellees.

APPELLEES' ANSWERING BRIEF

Appeal from the United States District Court for the District of Oregon

HON. JOHN F. KILKENNY, Judge

STATEMENT OF JURISDICTION

Appellant, Continental Casualty Company, an Illinois corporation, with its principal place of business in Chicago, filed a complaint for declaratory relief against Justin N. Reinhardt, Seymour L. Coblens, Norman A. Stoll, and Morton A. Winkel, attorneys at law practicing in Port-

land, Oregon. The jurisdiction of the District Court was based upon the provisionsof 28 U.S.C. § 2201, the Federal Declaratory Judgment Act. The amount in controversy is in excess of $10,000, exclusive of costs and interest, and there is diversity of citizenship between the parties.

Appellant has filed timely notice of appeal (R. 28) from a judgment adverse to it. The jurisdiction of this court is conferred by 28 U.S.C. § 1291.

STATEMENT OF THE CASE

Appellees adopt the statement of facts as generally set forth in Appellant's Opening Brief with the following additions.

As indicated, appellees' client, Mansfield & Company, held a default judgment against the Metropolitan Materials Company, an Oregon corporation in which Leslie E. Fordham was an officer, director, shareholder and accountant. In the course of supplementary proceedings, one of the appellees learned that certain corporate assets of Metropolitan Materials had been transferred to a partnership consisting of Fordham and Alan B. Kalkhoven, the president of Metropolitan, and that the financial statements of the corporation did not accurately reflect the amount of the shareholders' equity.

Appellee Winkel informed Metropolitan's attorney that if the matter was not settled an action would be filed against Fordham and Kalkhoven personally, and that if the action was filed a copy of the complaint would be forwarded to the Oregon State Board of Ac-

countancy. The action was filed, a copy of the complaint was sent to the State Board, and thereafter the case was tried. The trial judge (Crawford, J.), by written opinion in the state circuit court action, found in favor of Fordham and Kalkhoven. Although the Metropolitan assets were transferred to Fordham and Kalkhoven, and on its face this conduct appeared "unusual and somewhat irregular," the transaction was held to have been made in good faith, the situation being one in which "reason and integrity" were assumed on an analysis of corporate problems.

Shortly thereafter, Fordham filed an action for trade libel against appellees in the state circuit court. At all times previously referred to, appellees were insured (R. Tr. 3:19-20) under appellant's "Lawyer's Professional Liability Policy" (Pl. Ex. 101). The original complaint was duly tendered to the Continental Casualty Company and appellant declined the defense of the action in a letter dated August 25, 1964. As noted in appellant's statement of the case, motions to strike (Pl. Ex. 102-a) were allowed against portions of the Fordham complaint. That portion of paragraph XIV (Pl. Ex. 102) alleging that appellees' action was "taken strictly as what is commonly termed 'blackmail'" was ordered stricken. No amended complaint has as yet been filed in the state court action. The declaratory judgment action was then filed in the District court. It was there determined that appellant, under the terms of the policy, was bound to defend the action brought by Fordham against appellees (R. 19-22). Appellant has appealed from that judgment.

dicate potential liabilty which would be covered by the policy—an act which purportedly took place while appellees were performing professional services for a client. Does a lawyer perform professional services for a client other than in his capacity as a lawyer?

II. Where the complaint against an insured is ambiguous with respect to a fact determinative of coverage, the insurer is obligated to defend if there is potentially a case under the complaint within the coverage of the policy.

Blohm v. Glens Falls Insurance Co., ,231 Or. 410, 373 P.2d 412 (1962).

Lee v. Aetna Casualty & Surety Company, 178 F.2d 750 (2d. Cir., 1949).

Maryland Casualty Co. v. Pearson, 194 F.2d 284, 287 (2nd Cir., 1952).

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Jacoby v. United States Fidelity & Guaranty Co., 27 Misc. 2d 396, 199 N.Y.S.2d 537, 539-540 (1960).

If one party prepares a contract which is accepted by the other, any ambiguities will be resolved against the party preparing the contract. This doctrine has had great vitality in the construction of insurance policies as prepared by the companies. The purpose of insurance is the protection of the insured against contingencies he does not foresee and the courts have almost universally held that if there is an ambiguity as to coverage and the

limits thereof, such ambiguities will be resolved against the insurance company.

(A) Trade libel need not necessarily involve actual malice and appellant's duty to defend is not relieved by exclusion (a) of the policy.

Appellant contends that appellees' conduct was malicious and thus excluded from coverage under exclusion (a). The complaint filed against the insureds admittedly alleges malice (which, of course, must be set forth if Fordham is to recover the punitive damages prayed for). Appellant apparently bases this contention on the proposition that "malice" is an unambiguous term under the law of Oregon.

Appellees, however, respectfully submit that the term "malice" is an ambiguous one under the particular circumstances involved in the case at bar. The complaint filed against appellees in the state court is a cause of action in trade libel and in defamation cases the concept of malice is distinguishable from that utilized in other areas of the law. Libel need not be a malicious act in the sense the term is used in the "common parlance" referred to in Appellant's Brief (p. 11).

In the class of cases dealing with defamation it has come to be recognized that two distinct kinds of malice may exist—implied malice and actual malice. Since implied malice is nothing more than a legal fiction, a libel action need not necessarily be one involving malice. Therefore, exclusion (a) would not apply at all. At best, the term is ambiguous since actual malice need not be shown in order for Fordham to recover any damages

other than punitive. Even though the allegations of the state court complaint are based in part on excluded grounds, the insurer must still defend if the state court plaintiff could recover on such complaint on non-excluded grounds. (*Blohm* v. *Glen Falls, supra; Runyan, et al* v. *Continental Casualty Company,* 233 F. Supp. 214 (Or., 1964).

In support of its position, appellant has cited two Oregon decisions, neither of which is a defamation action. In the first case, *Jaco* v. *Baker,* 174 Or. 191, 148 P.2d 938 (1944), the plaintiff brought an action to recover for injuries received from the bites of a vicious dog. The second case, *Cook* v. *Kinzua Pine Mills,* 207 Or. 34, 293 P.2d 717 (1955), involved a collision between a truck and an automobile. Appellant relies on the general definition of malice set forth in these decisions as controlling in the case at bar. With this generalization we cannot agree.

As early as 1896, the Oregon court recognized the existence of two types of malice. In *Thomas* v. *Bowen,* 29 Or. 258, 45 Pac. 768 (1896), it was held that if a publication is libelous per se, malice is presumed. This state has continued to recognize the dichotomy. In *State* v. *Kerekes,* 225 Or. 352, 357 P.2d 413, 358 P2d 523 (1960), the defendant was accused of criminal libel. The court therein found that "malice," in libel cases, has acquired a double meaning and requires further refinement.

> "In cases which do not invoke privileged communications, 'malice' is said to be presumed from the false publication. This kind of presumed malice may or may not co-exist with actual malice." At p. 362.

Further examination of the early *Bowen* decision, supra, indicates that malice may even be an unnecessary allegation since where the law "presumes a fact it need not be stated in the pleading." Other jurisdictions have decided that malice is not a necessary element of civil libel for recovery of compensatory damages (e.g., see *Purvis* v. *Bremer's, Inc.*, 54 Wash. 2d 743, 344 P.2d 705 (1959)).

Harper & James comments on the question of malice in this way:

> "Perhaps no word in the law is used more loosely . . . It has been associated with the language of pleadings and opinions in cases of defamation for centuries, but it has been used with a double meaning. In the first place, although in complaints and declarations in libel and slander it is alleged that the defamatory statement was made 'maliciously,' the element of malice in the sense of bad or evil intention is not at all necessary to make the publication actionable. In fact, malice really has nothing to do with the case. . . . The plaintiff makes a complete case when he shows the publication of matter from which damage may be inferred. The actual fact may be that no malice exists or could be proved. . . . In the second place, malice, in the real sense, 'known in fact or experience,' is important in connection with the defense of qualified or conditional privilege. . . . The kind of malice necessary to defeat the protection of privilege has nothing to do with the 'malice' that is said to be 'presumed' from the publication of false and defamatory statements." (Harper & James, Law of Torts, v. I, § 5.27, p. 450 (1956); also, see Prosser on Torts, ch. 21, § 108, p. 790-91 (3rd ed., 1964)).

CERTIFICATE OF COUNSEL

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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No. 20418

United States
COURT OF APPEALS
for the Ninth Circuit

CONTINENTAL CASUALTY COMPANY,
a corporation,

Appellant,

v.

JUSTIN N. REINHARDT, SEYMOUR L. COBLENS,
NORMAN A. STOLL and MORTON A. WINKEL,

Appellees.

Appeal from the United States District Court
for the District of Oregon

APPELLANT'S REPLY BRIEF

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defend is to be measured by the allegations of the complaint filed against the insured. The Fordham complaint alleged an excluded claim and appellant, therefore, had no duty to defend. The Fordham complaint alleged malicious conduct which was excluded under exclusion (a); further, it alleged conduct of Winkel which was not an "act arising out of the performance of professional services for others in the assured's capacity as a lawyer." Therefore, appellant had no duty to defend.

The bulk of appellees' brief (Br. 7-11) is concerned with the proposition that "trade libel need not necessarily involve actual malice." Appellees therefore argue that appellant's duty to defend is not obviated by exclusion (a).

Appellants' policy expressly excludes coverage for "malicious acts" of the insureds. Appellees tend to turn the operative word from "malicious acts" into "malice" as the latter term is used in defamation actions. Superficially such an attempt seems plausible since the cause of action asserted against Winkel by Fordham was defamation. However, the fallacy is revealed when the basic issue is examined, i.e., whether Winkel and the partnership was entitled to a defense under a policy which excluded "malicious" conduct.

Appellant did not issue a "defamation" policy to appellees. Essentially, the insurance contract was a lawyers' errors and omissions policy designed to afford protection from the consequences of negligence and carelessness. Exclusion (a) was incorporated into the policy to specifically exclude wilful, fraudulent, criminal and

intentional misconduct on the part of the insured. The courts do not rewrite insurance policies merely because one party wishes expanded coverage *after* the fact. A reading of this policy indicates the intended coverage excluded the type of conduct allegedly committed by Winkel per the Fordham complaint.

Appellees urge that "malice" is ambiguous in defamation cases and, being susceptible to two meanings, the term should be construed most strongly against the insurer. The interim step in appellees' reasoning process is that one can libel another without "malice" as that term is commonly understood. Unfortunately appellees ignore the face of the complaint which governs appellant's duty to defend; the complaint alleges facts which are plainly excluded from coverage. Paragraph XIV (App. Br. 5) of Fordham's complaint eliminates any possible doubt evoked by appellees' brief. Paragraph XIV obviously charges Winkel with maliciously conducting himself in this endeavor; the allegations are not conclusory, but rather are of ultimate facts supporting the conclusion of maliciousness. Therefore, on the face of the complaint, no duty to defend exists.

Appellant fails to grasp the substance of appellees' contention that, at best, the Fordham complaint is premised in part upon grounds which are not excluded from coverage. Apparently it is contended that Fordham could recover general damages if "implied malice" is shown, but punitive damages only if "actual malice" is proven. First, it is clear that the *policy* makes no such distinction between "implied" and "actual" malice; the

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE LAHAINA-MAUI CORPORATION,
a California corporation,

Appellant,

v.

JOSEPH TAU TET HEW and HELEN AKIONA HEW, husband and wife, GEORGE TAN and SHIZUKO RUTH TAN, husband and wife,

Appellees.

No. 20419

BRIEF FOR THE LAHAINA-MAUI CORPORATION, APPELLANT

Appeal from Summary Judgment granted by the United States District Court for the District of Hawaii

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UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THE LAHAINA-MAUI CORPORATION,
a California corporation,

Appellant,

v.

JOSEPH TAU TET HEW and HELEN AKIONA HEW, husband and wife, GEORGE TAN and SHIZUKO RUTH TAN, husband and wife,

Appellees.

No. 20419
Appeal from Summary Judgment granted by the United States District Court for the District of Hawaii

BRIEF FOR THE LAHAINA-MAUI CORPORATION, APPELLANT

JURISDICTIONAL STATEMENT

Plaintiffs-Appellees are citizens of Hawaii. Defendant-Appellant corporation was organized and exists under the laws of the State of California and has its principal place of business in California (R.41-2).

This is a controversy of which the United States District Courts have original jurisdiction in that the controversy is wholly between citizens of different States and the amount in controversy, exclusive of interest and costs, exceeds

$10,000.00, pursuant to Section 1332 of the Judicial Code, 28 USCA 1335.

The U. S. District Court for the State of Hawaii after granting a Petition for Removal (R.41-2) pursuant to Section 1441 of the Judicial Code, 28 USCA 1441, entered Summary Judgment granting relief prayed for by the Plaintiffs-Appellees and denying relief prayed for by Defendant-Appellant.

Notice of Appeal from that Judgment to this Honorable Court was filed on the 30th day of June 1965 (R 113).

STATEMENT OF FACTS

On or about February 15, 1963, Appellant's predecessors in interest completed negotiations with Plaintiffs-Appellees for the lease from Appellees of certain unimproved land in the town of Lahaina, Island and County of Maui, State of Hawaii. On February 15, 1963, an option to lease such property was executed by Appellees and delivered to Defendant-Appellant's predecessors in interest in return for a consideration of $1,000.00 paid by Defendant's predecessors in interest. The option and an extension thereof are Exhibits A and B respectively to Plaintiffs' complaint (Record pp 8-12). On July 26, 1963, the option was assigned to Appellant and on this same date Appellant and its predecessors in interest unconditionally exercised the option by signing and delivering to Appellees a "Notice of Exercise of Option to Lease" (Record p 102).. On August 23, 1963, Appellees formally declined to execute a lease. On August 29, 1963, they filed a complaint in the Circuit Court of the Second Circuit, State of Hawaii alleging that the option to lease constituted a cloud upon their title and asking for cancellation of the said option. On September 11, 1963, Appellant removed the cause to the

United States District Court for the District of Hawaii and filed an answer denying the allegations of Plaintiffs. Defendants also filed a counterclaim praying that Appellees be required to specifically perform their obligations under the contract to lease and for damages in addition; the said counterclaim also prayed for damages in the event a decree of specific performance was not granted.

The option executed by Appellees contained the names of the parties, a description of the premises, the term of the lease and of the option and the rental to be paid. Other matters to be included in the lease were disposed of by the following provision:

> Said lease shall contain the standard provisions normally contained in a lease for similar property situate in the State of Hawaii together with the provision that the Lessor shall subordinate their fee to permit the Lessee to obtain financing which provision is by way of example, but not by way of limitation.

On January 5, 1965, Plaintiffs-Appellees filed a "Motion to Dismiss Counterclaim or, in the Alternative, Motion for Summary Judgment" (Record pp 99-101) essentially on the

ground that the above provision was vague and indefinite and thus not specifically enforceable. After hearing on the motion the court below ruled orally on January 7, 1965, that in all respects save one the option to lease was governed by Francone v. McClay, 41 Haw. 72 (1955) and was thus specifically enforceable (Record pp 104-109). The offending provision, according to the court, was the latter portion of the clause quoted above; i.e.:

> . . . together with the provision that the Lessor shall subordinate their fee to permit the Lessee to obtain financing . . . .

The court found this provision uncertain notwithstanding defendant's offer in open court to provide expert testimony to the effect that it was clear and complete and that a subordination clause could be drawn from it without further negotiation or clarification (Record 112, 113).

Appellant, however, offered in open court to waive all benefit under the offending provision in order to obtain a decree of specific performance and judgment was withheld pending submission of briefs and oral argument by the parties on the effect of this waiver. On June 14, 1965, the court below granted Appellees' motion for summary judgment (Record

p 114-118) finding essentially that the clause quoted above was "so vague, indefinite and uncertain" that the entire option could not be specifically enforced. As to Appellant's waiver of the provision, it was held ineffective on the ground that the subordination clause was for the benefit of both parties, not the Appellant alone. No mention was made in the court's ruling of Appellant's prayer for damages in the event specific performance was not to be granted. The court also, in its order, cancelled the lis pendens previously recorded by Appellant in the Bureau of Conveyances of the State of Hawaii (Record p 119-121).

SPECIFICATION OF ERRORS

1) The court could not properly find on a motion for summary judgment that the subordination clause was too indefinite for specific performance, particularly in light of Appellant's offer in open court to provide testimony and evidence to the contrary.

2) In any case, the court erred in finding as a matter of law that the subordination clause pertinent to this case was so indefinite as to render the option incapable of specific performance.

3) Even assuming the court properly found the subordination clause to be unenforceable, the court should have refused to grant summary judgment since the proper remedy in such case would be to grant specific performance conditioned upon Appellant foregoing the benefits it was to receive under the unenforceable clause.

4) Even assuming the court would not be required to grant the remedy described above, the court committed error in refusing to accept Appellant's waiver of the benefits accruing to it in the subordination clause thereby rendering the option specifically enforceable.

5) Even assuming results unfavorable to Appellant in all the above specifications, the court committed error in granting Summary Judgment since even if the contract between Appellees and Appellant was too indefinite for specific performance, it could still be the object of a damage action.

6) The court erred as a matter of law in cancelling Appellant's lis pendens.

SUMMARY OF ARGUMENT

The District Court erred in ruling that the subordination clause was indefinite and not capable of specific enforcement because the clause, on its face, is clear, complete and definite. Even if the court had doubts as to its definiteness, it should not have granted a summary judgment, but rather should have heard the expert witnesses proffered by appellant, a course of which in a case of this kind is accepted procedure under Hawaii law. In any event, the court should have accepted appellant's offer to waive the benefits to which it was entitled under the subordination clause and should have ruled that this waiver cured the contract of any indefiniteness and thus of any bar to specific enforceability. Such waiver is a common procedure where it is not possible to enforce a part of the performance required of the other party and the waiving party is willing to forego the benefit of such performance in order to obtain specific performance of the remainder.

But even if the court were correct in ruling summarily that specific enforcement of the contract could not be granted, it failed to understand that a substantially lesser degree of definiteness is required of contracts which are the subject of an action for damages than is required by equity for specific enforcement. The contract in this case quite clearly will sustain

an action for damages, yet the court granted summary judgment to appellees even over appellant's claim for damages in lieu of specific performance if the latter were not granted.

Finally, the court erred in cancelling appellant's lis pendens since it did so without a shred of evidence that it justification for such an action and since such an act was beyond the court's power.

ARGUMENT

I. The Subordination Clause:

Subordination agreements most frequently arise in the context of a purchase of unimproved real property when part of the payment is deferred and secured by a purchase money mortgage. This mortgage will have priority over any subsequent mortgage taken out by the purchaser, but, in many transactions, the purchaser obtains the seller's consent -- usually as part of the terms of sale -- to permit such a subsequent mortgage to assume priority. Where the transaction involves a lease rather than a purchase, the agreement to subordinate is made by the Lessor who agrees to permit the Lessee to subject his fee simple interest to a mortgage. The latter situation involves, in effect, the grant to the Lessee of a special interest in the fee -- an interest permitting the Lessee to encumber the fee, but nothing more. Whether as part of a lease or of a sale, the sole purpose and function of a subordination agreement is to assist the Lessee or purchaser in obtaining financing; such agreements constitute a common and important device in the financing of improvements to realty in many areas of the country.

As may be seen, an unrestricted agreement by a Lessor to subordinate his fee simple interest to a mortgage presents a

potential hazard for the Lessor in this respect: where the Lessee would normally have had to invest a certain portion of his own funds to finance improvements, he might now be able to utilize the value of the fee simple interest for borrowing purposes, thus reducing or even eliminating the need for his own funds. In such a case, the encumbrance upon the improvements might approximate or equal their value, thus reducing the Lessor's "insurance" -- or security -- in the event of a breach of the lease necessitating its cancellation and the taking over of the improvements by Lessee. The same hazard exists, of course, to a seller. Notwithstanding the risk, many subordination clauses are drawn, like the one in this case, without restrictions of any kind upon the mortgage to which subordination will be allowed.[1] Others contain restrictions for the protection of the seller or Lessor, often limiting the use of funds borrowed under such mortgages to financing improvements[2] and/or restricting the amount of the mortgage to a specified percentage of the value of the improvements.[3]

1/ See, Applefield v. Fidelity Federal Savings and Loan Association of Tampa, 137 S. 2d.259 (Ct. App. Fla. 1962)

2/ See, e.g., York Mortgage Co. v. Clotar Construction Corp., 254 N.Y. 128, 172 N.E. 265 (1930); Lorder v. Perlmar, 129 App. Div. 93, 113 N.Y. Supp. 420 (1908).

3/ See, e.g. Darst v. Bates, 95 Ill. 493 (1880). See also, Brooklyn Trust Co. v. Fairfield Gardens, 260 N.Y. 16, 182 N.E. 231 (1932) (Subordination limited to a particular mortgage).

Essentially, Plaintiffs' claim respecting the alleged indefiniteness of the subordination clause is that it is incomplete because no restrictions were set forth in the option. The answer to this claim is obvious: there are no restrictions.[4/] The phrase, "Lessor shall subordinate their fee to permit the Lessee to obtain financing" may lack something grammatically but it is as clear, definite and unequivocal as a phrase can be.[5/] It is a simple matter to prepare a clause for insertion in a lease reflecting the agreement of the parties as shown by this provision with no possibility of misunderstanding or distortion of the stated intent. Indeed, the Defendant stated in open court on two occasions that it would provide experts to testify at the trial of this matter that the clause had a definite and ascertainable meaning as it stood. (pp 112, 113) In Francone v. McClay, 41 Haw. 72 (1955), the Supreme Court of Hawaii affirmed

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4/ If Plaintiffs' contention is that restrictions were intended but were somehow left out of the written agreement, the Plaintffs are raising a question of fact which is disputed by the answer and which is, therefore, incapable of adjudication by a Summary Judgment. Fed. Rules of Civil Procedure 56(c).

5/ It might have been possible to manufacture a claim of ambiguity on the ground that there was no specification of what the "financing" was to be used for. Defendant, however, admits and has never denied that this word was intended to, and does, refer to the financing of improvements on the subject property.

decree of specific performance of a contract to lease almost recisely like ours as against a claim that it was indefinite. he testimony of Mr. Howard Moore, "a member of the Bar and an xpert in realty transactions," was accepted by the trial court nd apparently relied upon by the Supreme Court in holding that s to long term leases, a contract containing a provision that he lease shall contain "all other usual covenants" was ufficiently definite to be specifically enforceable. Appellant ffered the testimony of the same expert to the same effect as is testimony in that case; i.e., that the challenged sub-rdination clause is sufficiently clear and definite to be ranslated into a formal and complete lease clause without any urther information being necessary. (Record pp. 112, 113). he Francone case establishes that, under Hawaii law (which overns this case), the definiteness and thus enforceability f lease provisions is a question of fact, or at least a uestion upon which the testimony of experts in the community is elevant. The court below thus should not have granted a ummary judgment on the question, particularly when the only roffered testimony was directly contrary to the court's ruling.

The District Court ruled here, in essence, that an greement to subordinate is not complete unless there are re-trictions upon same and unless they are spelled out. In short, n owner of property cannot enter into an agreement to subordinate

less he also negotiates and obtains conditions upon such agree-
nt which are protective to him and restrictive upon the other
rty. The absurdity of such a rule becomes apparent when a
bordination agreement is viewed in its proper perspective
th other security devices. In most states, and in Hawaii, a
ller of land taking less than the full purchase price in cash
uld receive a promissory note for which the purchaser was
rsonally liable[6/] as well as the added security of a mortgage
the property. It is clear that a seller of land in such a
ate could, if he wished, omit the mortgage entirely and accept
promissory note for the unpaid balance of the purchase price,
ereby relying directly on the seller's personal credit with-
t any further security; equally the seller could insist on
curity in the form of a mortgage on the land and of all future
provements, as well as all other real and personal belongings
the buyer. In short, the seller could accept anything in a
nge from no security at all to an almost infinite amount of
curity. Whether he wants security at all and, if so, how much,
e clearly matters left to be decided between him and his purchaser
the absence of fraud the courts never have been

Wodehouse v. Hawaiian Trust Co., 32 Haw. 835 (1933)

willing to interfere.[7] There is no difference except in degree between, 1) a seller relying solely on the purchaser's personal credit and having no mortgage at all as security, 2) a seller having as security a purchase money mortgage which he has agreed to subordinate to whatever other mortgage the purchaser may place on the property, 3) a seller having as security a purchase money mortgage which he is willing to subordinate only within prescribed limitations, and 4) a seller having a purchase money mortgage which he is not willing to subordinate at all. All are simply degrees of security and are for the determination of buyer and seller, not a court.[8]

7/ CF Brown v. Carter, 15 Haw. 333 (1903); Durbank v. Wood, 2 Haw. 591 (1862) ("Whether it was a wise and judicious contract is not for the court to say."); Wodehouse op. cit. at 843 ("courts of equity do not thus come to the assistance of persons of legal age and of sound mind in a transaction free from mistake and fraud who have merely committed an error of judgment").

8/ In California, however, an entirely different situation prevails, for by statute the purchaser of property has no personal liability under a purchase money mortgage. California Civil Procedure Code §580(b). This may help explain the existence of a couple of cases from the intermediate appellate courts of that state holding that an unrestricted agreement to subordinate by sellers taking purchase money mortgages is unenforceable. Kessler v. Sapp, 169 Cal. App. 2d. 818, 338 P2d. 34 (1959); Wright v. Fred Hoydes Industries, 6 Cal. Rptr. 392 (Ct. App. 1959). Neither of these cases gives any reasoning or explanation of its action; both rely heavily on equally unreasoned obiter dictum in Gould v. Callan, 127 Cal. App. 2d.1, 273 P.2d. 93 (1954) which they incorrectly refer to as the "holding" of that case.

The one case which Appellant has been able to find from a comparabl jurisdiction which is squarely in point is McCarty v. Harris, 113 So. 233 (Ala. 1927); specific performance was granted.

The District court erred in its decision to the effect that the subordination clause is incapable of specific performance because it refused to accept the testimony of experts as required by Hawaii law. In any event, its decision produces a rule wholly out of keeping with Hawaii jurisprudence--and, indeed, anomalous in the jurisprudence of the common law. The court should be reversed.

II. Waiver

Even if it should be found that the subordination clause this case cannot be specifically enforced the court below ould not have granted summary judgment. The proper remedy such a case is to grant defendant specific performance condi-oned upon defendant's waiving its right to benefits under the bordination clause.[9/] In this case, of course, it was not cessary for the court to decree specific performance in a con-tional form for defendant offered in open court to waive its nefits under the subordination clause. The law is settled and ite clear that an indefinate provision or provisions in a con-act otherwise suitable for specific enforcement may be waived the party entitled to the benefit thereunder and that that rty then becomes entitled to the specific enforcement of the lance of the contract. Some examples from the writers and eatises:

Restatement, Contracts §365

> The fact that a part of the promised performance cannot be rendered, or is otherwise such that its specific enforcement would violate some of the rules stated in §§360-380 does not prevent the specific enforcement of the remainder, if in all other respects the requisites for specific performance of that remainder exist....(among the rules in §§360-380 is that in §370 forbidding specific enforcement of terms which are undertain).

E.g., Hubbell v. Ward, 40 Wash. 2d 779, 246 P 2d 468 (1952)

49 Am.Jur. Specific Performance, §77

> Where the plaintiff is willing to perform all of his obligations under a contract, he may waive the failure of the defendant to perform portions of the contract, and obtain specific performance of the balance of the contract, provided the case is otherwise an appropriate one for such a decree.

Pomeroy's Specific Performance of Contracts §161(3rd Ed. 1926)

> If an agreement consists of two parts which are separable, so that one portion could be enforced by itself, it would be no objection to a specific execution of one such part that the other is too uncertain to admit of the same remedy.

Fry on Specific Performance of Contracts §361(note 1, p. 175)

> It will be no objection to decreeing specific performance of a part of a contract, that another part is uncertain. (See also id. at §§355, 966.)

There is a very large body of case law decreeing partial r conditional specific performance of contracts such as ours. erhaps the situation which arises most frequently is that in hich a vendor or lessor owns some interest but does not have s good title as he agreed to convey. In all such cases the courts ave granted specific performance at the insistence of the vendee r lessee, requiring conveyance of all the vendor has even though he flaw in his title may be such that he could not himself have btained specific performance.[10/]

10/ 4 Pomeroy's Equity Jurisprudence §1405b (5th Ed. 1941)

r example, in Lee Wah Koon v. Maui Dry Goods and Grocery Company, d., 30 Haw. 313 (1928), the defendant was lessee of some 14 res of land which it had subleased to one Takemori. Defendant tered into an agreement with plaintiff whereby it was to assign plaintiff all its right, title and interest in the leased land well as the title and interest of Takemori. At the time for rformance Takemori was unwilling to release his interest and e defendant was unable to induce him to do so. Plaintiff ought an action for specific performance. Held: Defendant st convey all the interest which it owns and must pay compen- tion to the plaintiff, by way of reduction in the purchase, the value of Takemori's interest. (In this case the compen- tion ammounted to almost the entire purchase price.)[11/] These ses make it clear that if appellees were unable to perform their reement to make their fee simple interest available to the lessee r mortgage purposes because they did not own the fee simple, ssee could waive that defect and obtain specific performance the remainder of the agreement. There should be no difference outcome where the owners are able to perform, but need not do because of a lack of the requisite definiteness in the agree- nt.

/ For examples of this situation outside this jurisdiction, see e.g., Torelle v. Templeman, 94 Mont. 149, 21 P.2d 60 (1933); Eppstein v. Cuhn, 225 Ill. 115, 80 N.E. 80 (1906); Levine v. LaFayette Building Corp., 103 N.J.Eq. 121, 142 Atl. 441 (1928); 10 L.R.A. (N.S.) 117; Case Note, 23 Mich. L.R. 535 (1925).

In any event, there is an almost equally large body of se law decreeing partial or conditional specific enforcement contracts in which one or more terms cannot be specifically forced because indefinite. These cases are entirely undistinshable from our own.

A provision which frequently seems to be indefinite is at providing for deferred payment of all or a part of the purase price in options or contracts. Often such terms as rate interest, period of deferment, form or terms of security and en amount to be deferred are left unstated or are specifically ft for future agreement. These provisions are not specifically forceable at the behest of the optionee or buyer, but the urts enforce the options or contracts subject to waiver by the tionee or buyer of the right to defer. For example: In anton v. Williams, 209 Ga. 16, 70 S.E.2d 461 (1952), the parties tered into an agreement for the purchase of land with a house to built thereon. The payment terms recited in the agreement were at the total purchase price was to be $10,000, of which $4,000 s to be paid in cash with the balance to be obtained by purchaser obtaining a "G.I. Loan". If he could not obtain such a loan, e seller was himself to loan the balance to the purchaser. No te of maturity, interest rate, or amount of monthly payments s stated. The purchaser was unable to obtain a G.I. Loan. The ller's defense to a bill for specific performance was based in rt upon the indefiniteness of the loan provisions. The court

: "But the offer of the purchaser to pay cash is a waiver of provision which is for his benefit, and he has a right to e it. This waiver eliminates that portion of the contract ting to the loan, including the indefiniteness". There was apparently an indefiniteness concerning the specifications construction of the house and this indefiniteness was also ed upon by the seller. Again the court held that the buyers' ingness to accept the house as it was waived all indefiniteness.

In Hubbell v. Ward, 40 Wash2d 779, 246 P.2d 468 (1952), ntiff and defendant executed an earnest money receipt and ement for the purchase of an apartment house. Plaintiff was ay $9,000 upon evidence of merchantable title and to "sign ntract for the balance, payable at $200.00 or more per month, uding interest at the rate of 5% on deferred balances". The t found this provision too indefinite for specific enforce- because there was no "standard" contract in that state to h the parties could have had reference. The court granted a ee of partial specific performance, however, conditional plaintiff's tendering "payment of the balance of the full ract price of $29,000 within a reasonable time".

In Trotter v. Lewis, 185 Md. 528, 45 A2d 329 (1946), e was an option in a lease of land whereby the lessee could hase it at a "price not to exceed $2,500, with interest not xceed 6% per annum". Held: Specific performance will be

granted conditioned upon the purchaser to [illegible]
in cash.[12]/

Of course, the principle of [illegible]
specific performance is not limited to [illegible]
deferred payment, any more than it is [illegible]
insufficient title. As the Flexton case ([illegible]), [illegible]
to any indefinite provision in a contract, [illegible]
that the provision is for the benefit of the [illegible]
ic performance. The following cases provide examples of [illegible]
tion to a variety of indefinite provisions.

In Prilik v. Goodman, 111 N.Y.S. 2d [illegible] (Sup. Ct. 1[illegible]
plaintiff entered into a contract with defendant to purch[illegible]
drug store business; part of the contract was that defend[illegible]
to give plaintiff a five year lease on the premises upon [illegible]
drug store stood at a rental of $100 per month with an option to
extend the lease for an additional 5 years at $110 per month. No
details of the lease were included in the agreement. Plaintiff
brought an action for specific performance. In a motion to
dismiss brought by the defendant on the grounds of indefinite-
ness, the court denied the motion and said: "The main relief
sought herein is the specific performance of the agreement by
defendant to sell plaintiff a drug store business. If, after
trial, it develops that the court cannot grant specific performance
of that part of the agreement to 'deliver' a lease to plaintiff,

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12/ See also Morris v. Ballard, 56 App. D.C. 333, 16 F. 2d 175 (1926)
Levine v. LaFayette Bldg. Corp., 103 N.J.Eq 121, 142 Atl. 441
(1928); Haire v. Patterson, 386 P2d 953 (Wash. 1963)

latter may elect to accept and the court may decree part
cific performance to the extent of the vendor's ability to
ply with the other terms of the agreement". (Id. at 918)

In Jasper v. Wilson, 14 N.Mex. 482, 94 Pac. 951 (1908),
vendee entered into an agreement with the agent of the owner
the property whereby the vendee was to purchase it and obtain
arranty deed. The owner defended on the ground that the
nt had no authority to grant a warranty deed. The vendee
willing to accept title without warranties. The court said:
is a well recognized principle of equity that a vendee, in
action brought by him for specific performance of a contract,
waive the performance on the part of the vendor of portions
his contract, and may elect to take a partial performance
he himself is willing to perform". Here, although the agent
have exceeded his powers, the plaintiff waived such excess
was entitled to a decree of specific performance.[13/]

The authorities have been laid out in what was, perhaps,
essive detail. Nevertheless, they establish beyond doubt that
cific performance conditioned upon waiver of an unenforceable
vision is neither a novel nor an unusual procedure. Rather,
is a standard equitable remedy utilized throughout the common
jurisdictions. They further establish that ours is a classic

See also Wright v. Houdaille Hershey Corp., 321 Mich. 21, 31 N.W.2d 85 (1948); Neely v. Broadstreet National Bank of Redbank, 16 FSupp. 839 (D.N.J. 1936).

ase for application of the remedy. We have a contract, valid, inding and fully enforceable in all its terms save one; that one s for the benefit only of the party seeking the court's aid. his is the same situation which prevailed in virtually every one f the cases cited and discussed above; they are indistinquishable om this case and compel a conclusion that the plaintiff's motion r summary judgment should be denied. The District court ruled, wever, that the very existence of the subordination clause with- the option rendered the entire option tainted forever insofar specific enforceability is concerned. Nor could waiver by the fendant of its benefits under the subordination clause render e balance of the contract specifically enforceable, notwithstand- g that the balance was definite and appropriate for specific forcement. (Record pp. 105-06). In the court's own words:

> When one reads the entire paragraph in the "Option to Lease", supra, pertinent here, it does not appear with any certainty whatsoever that the subordination of the fee clause was intended and understood by the parties to be solely for the benefit of the lessee. The subordination clause was tightly entwined with "the standard provisions normally contained in" a Hawaiian lease and was clearly tied into the above "provisions" by the words which followed

the subordination clause, viz., "which provision (for subordination) is by way of example, but not by way of limitation."

That the subordination clause was so delineated, unequivocally indicates that it was intended to be an integral and highly essential provision of the lease -- as this court has previously ruled -- and manifestly thus was intended to be for the benefit of both parties -- not the vendee alone. The term of the lease was to be 56 1/2 years. If a building of x value were placed thereon, it might be completely depreciated by the time the lease expired, whereas if a building of y value were built thereon, it might still be of great value to the lessor at the termination of the lease. The difference between an x or y building might well be the difference between subordination and no subordination of the fee, and in that difference the plaintiff had an obvious interest and potential benefit.

Unless it can be said with certainty that the option, on its face, shows the subordination clause was intended solely to benefit the lessee, then an attempted unilateral waiver by the lessee of that

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Unless it can be said with certainty that the option, on its face, shows the subordination clause was intended solely to benefit the lessee, then an attempted unilateral waiver by the lessee of that

which to the contrary, apparently was for the mutual benefit of both parties is deficient. A mutual right cannot be waived unilaterally. (Cite omitted) (Record pp. 117-118).[14/]

Somehow the court became confused between the apparent ortance of the clause as indicated by its location in the agree- and the question whose benefit it was for. There is no re- on between the two.[15/] This confusion is unfortunate for it lear, both from the language of the option and from the na- of subordination, that the clause provides no benefit what- to the owners. The language of the provision -- "The Lessor l subordinate their fee to permit the Lessee to obtain financing" laces a duty only upon the Lessor; the Lessee is required to othing. There is no obligation, implied or otherwise, the Lessee to utilize the funds obtained because

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In the almost 75 pages of briefs and memoranda filed and the extensive oral argument presented in the District Court preceding this ruling, only an occasional passing reference was made to the claim that the subordination clause was for the benefit of appellees. Their attorney made no serious attempt to argue or present this theory and it was not mentioned by the court prior to issuance of the ruling quoted above.

For example, one can imagine a provision bargained for and obtained by the Lessee permitting him to cancel the lease on 30 days notice. Such a provision might be of the utmost importance insofar as the Lessee is concerned, but the fact that it is important does not in any way make it beneficial to the Lessor. The same is true, of course, of many other more common provisions such as an option to extend the lease or to purchase the fee simple title at a given price or a provision calling for the rent to go up (or down) to a certain figure at a given time.

ich it must repay) investing the same uneconomically and un-
fitably in prolonging the life of the improvements beyond the
e when they will benefit him. Surely, this kind of possible -
-unlikely, indirect, potential advantage does not transform
subordination clause into something designed for the benefit
the Lessor. 16/ In many of the cases previously cited, the
ties had stipulated that payment of a purchase price was to be
e over a period of time at a given rate of interest.17/ It is
more plausible that the sellers in those cases would have re-
ved some benefit from deferred payment (either because of their
situation or because the interest to be received was more than
y could earn otherwise) than that the Lessors in this case will
r receive any benefit from subordination. Yet, in each of those
es, the court permitted specific performance on the basis of
buyer's willingness to pay all cash. These cases thus estab-
h that the right to waive is not limited to provisions which
ld never, under any stretch of the imagination, be beneficial
the other party; rather waiver is proper of provisions where
direct, bargained-for benefit accrues to the waiving party.

Indeed, one wonders why, if the clause is beneficial to these Lessors, they have refused to perform under it.

E.g., Blanton vs. Williams, 209 Ga.16, 70 S.E.2d 461 (1952); Hubbell v. Ward, 40 Wash.2d 779, 246 P.2d 468 (1952); and Trotter v. Lewis, 185 Md. 528, 45A.2d 329 (1946).

The rationale underlying all the waiver cases previously
ed is not only the general policy of the common law that contracts
ht to be enforced where possible in order to effectuate the in-
tions of the parties;[18] There is also a strong feeling that
is unfair to permit a party to a contract who has avoided one
his obligations thereunder because of some defect to assert
own avoidance as an excuse for avoiding the balance of his
igations as well.[19] To permit this would be to permit a
iberate avoidance of the general policy in favor of contract
orcement, and it would constitute a turning away by courts of
ity from their traditional reliance upon substance and actual
ent toward a mechanical jurisprudence based upon technicality
form.[20] For these reasons, it has not been permitted.[21]

The appellees are in a somewhat awkward position in this
e for they first assert their unwillingness to perform a given
y under the lease and, then, must convince the court that this

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See e.g., 17 Am.Jur.2d, Contracts §§175, 244, 254. F.S. Royster Guano Co. v. Hall, 68 Fed. 2d 533 (C.A.4 1934).

See Morris v. Ballard, 56 App.D.C. 383, 16 Fed. 2d 175 (1926); Pomeroy's Specific Performance of Contracts (3d Ed. 1926) Sec. 155; Fry on Specific Performance of Contracts (3d Ed. 1884) Sec. 830.

4 Pomeroy's Equity Jurisprudence §378 (5th Ed. 1941).

See note 19, supra; discussion of waiver cases, passim.

was really for their benefit. If appellees wish, the appel-
will be happy to alter its offer to waive the subordination
sion by offering to waive only so much thereof as appellees
e; the appellees may then subordinate their fee simple inter-
s much as they wish.

The District Court was in error in refusing to accept
lant's offer to waive its benefits under the subordination
e and should be reversed on this ground.

Appellant's Claim for Damages in Lieu of Specific Performance:

Even if specific performance is not an appropriate remedy is case, the District Court erred in granting summary judgment ppellees since appellant was still entitled to an award of es. The law is clear that a finding of indefiniteness or un- eteness sufficient to render a contract incapable of specific rmance, is not also a finding that the complaining party can- btain damages for the breach thereof. For example, Pomery

> greater certainty is required in the terms of an agreement which is to be specifically executed in equity than is necessary in a contract which is to be the basis of an action at law for damages. An action at law is founded upon the mere non-performance of the defendant and this negative conclusion can often be established without determining all the terms of the agreement with exactness.
>
> Pomeroy's Specific Performance of Contracts, (3d Ed. 1884) Sec. 361.

even though an agreement may be too indefinite in its terms pecific enforcement, it may be certain enough to constitute

lid contract for breach of which damages may be recovered.

The requirements of definiteness which must be met by a ract in order to maintain an action for damages for the ch thereof are stated in 17 Am. Jur., Contracts, §§75-85. e are that it must be sufficiently definite in its essential s as to time for performance, subject matter and quantity and e or consideration to allow a court to determine whether its s have been breached. In this case a clear and definite of- to lease designated property for a definite period at a set e was made by the appellees and unequivocally accepted by llant.

Only one term has been deemed indefinite, and that term ntirely unnecessary to a determination of whether there has performance by the appellee or to a determination of the nt of damages suffered by appellant. To some extent it t be argued that the clause would at least be helpful in rmining the amount of damages, since appellant's lease would been more valuable with an unrestricted subordination agree- in it than without, and its damages would therefore have greater. Appellant, however, will waive performance under subordination clause by appellee and thus eliminate any pos- lity of difficulty with respect to damage computation. 22/

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17 Am. Jur. 2d, Contracts, §390

If the District Court found that the contract in this case too indefinite to sustain a damage action, it was clearly rror. Appellant in its counterclaim alleged all necessary nts to an action in damages which raised substantial issues ct between the parties, and the summary judgment was, there- improperly granted.

IV. Lis Pendens:

In its final order, the District Court erroneously ancelled the lis pendens recorded by the appellant in the Bureau f Conveyances in the State of Hawaii on October 25, 1963. The iling of lis pendens in Hawaii is governed by statute, the pplicable provision of which is as follows: "In any action, hether at law or in equity, affecting the title or the right f possession of real property, the plaintiff, complainant or etitioner at the time of filing the complaint or petition or ill in equity, and the defendant or respondent, at the time of iling his answer, when affirmative relief is claimed in such nswer, shall record in the Bureau of Conveyances a notice of the endency of the action, containing the names of the parties and he object of the action or defense, and a description of the roperty affected thereby. From and after the time of filing uch notice for record, a purchaser or incumbrancer of the property ffected shall be deemed to have constructive notice of the pen- ency of such action, and of its pendency against parties desig- ated by their real names."[23]

Appellant, upon removal of this case to the Federal ourt and upon filing its answer hereunder, recorded a lis pendens erving notice of the pendency of this suit as authorized by sta- ute. A lis pendens does not expire upon issuance of a judgment,

---

3/ Revised Laws of Hawaii (1955) Sec. 230-42

t only upon the final determination of the case, including
e outcome of any appeals.[24] Appellant's right to record a
s pendens and thereby obtain the protection granted it by the
gislature of the State of Hawaii is unconditional. The effect
the District Court's action is to deprive the Appellant of
is right without any reason or justification therefor and
thout any finding of fact or law to support its action. This
error, if for no other reason than that a Federal Court must
llow the substantive law of the State in diversity cases.[25]
was also error because, as a matter of law, a court, absent
atutory authorization, has no authority to cancel a lis pendens.[26]

/ E.g., Wilkin v. Shell Oil Co., 197 F.2d 42 (1952); Maedel v. Wies, 15 N.W. 2d 692 (Mich. 1944); Kremer v. Schutz, 107 Pac. 780 (Kan. 1910).

/ Erie R. R. v. Tompkins, 304 U.S. 64, 82 L. Ed. 188 (1938)

/ Moran v. Midland Farms Company, 282 S.W. 608 (Tex. 1926); Marpret Corp. v. Hargust Corp., 210 N.Y.S. 465 (1925); Corpus Juris Secundum, Lis pendens Section 37.

CONCLUSION

For the reasons previously stated, the District Court rred in its conclusion that the subordination clause was too ndefinite for specific enforcement and further erred in its nclusion that Defendants offered to waive its benefits under at clause, was invalid and did not correct any indefiniteness hich might exist therein. This court should reverse the District ourt's grant of summary judgment to Appellees and remand, with structions to set the matter for trial. In the alternative, his court should find that the District Court erred in granting ppellee's motion for summary judgment as against Appellant's rayer for pecuniary damages.

In addition, this court should rule that the pur- orted cancellation of Defendant's lis pendens by the District ourt was error and should reverse the District Court in this spect.

I certify that, in connection with the preparation of his brief, I have examined Rules 18 and 19 of the United States ourt of Appeals for the Ninth Circuit, and that, in my opinion, he foregoing brief is in full compliance with those rules.

Richard P. Schulze, Jr.
Attorney for the Appellant

UNITED STATES CO[illegible]

FOR THE N[illegible]

HE LAHAINA-MAUI CORPORATION, a California corporation,	)	
Appellant,	)	N. [illegible]
-vs-	)	
OSEPH TAU TET HEW and HELEN KIOMA HEW, husband and wife, EORGE TAN and SHIZUKO RUTH T[illegible], usband and wife,	)	
Appellees.	)	

C[illegible]

I hereby certify that on the [illegible] day of [illegible], [illegible] caused to be mailed (First Class Mail) [illegible] ffice at Honolulu, Hawaii, postage thereon [illegible] hree copies of the fore-oing brief of th[illegible] HE LAHAINA-MAUI CORPORATION, addressed to [illegible] mith, Wild, Beebe & Cades, First National [illegible] onolulu, Hawaii.

DATED at Honolulu, Hawaii this [illegible] day of [illegible], 965.

RI[illegible] P. [illegible], JR.

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LAHAINA-MAUI CORPORATION, a California corporation, Appellant, v. PH TAU TET HEW and HELEN NA HEW, husband and wife, GE TAN and SHIZUKO RUTH husband and wife, Appellees.	NO. 2414 APPEAL FROM SUMMARY JUDGMENT GRANTED BY THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAII. Chief Judge Martin Pence

FEB 1 1957

BRIEF FOR APPELLEES

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UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LAHAINA-MAUI CORPORATION, a California corporation, Appellant, v. SEPH TAU TET HEW and HELEN ONA HEW, husband and wife, RGE TAN and SHIZUKO RUTH , husband and wife, Appellees.	)	NO. 20419 APPEAL FROM SUMMARY JUDGMENT GRANTED BY THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAII Chief Judge Martin Pence

BRIEF FOR APPELLEES

JURISDICTIONAL STATEMENT

Appellees concur in the jurisdictional statement the Appellant.

STATEMENT OF FACTS

On June 30, 1965, judgment was entered against Appellant on the Appellees' motion for summary judgment er Rule 56 of the Federal Rules of Civil Procedure 119-121). The court below found that there was no uine issue as to any material fact and stated in its ision that it relied upon the language of the alleged tion to Lease", the Complaint, the Answers (presumably to Complaint and the Interrogatories), and the Notice of

rcise of Option of Lease for its decision (R:110).

Appellant did not file an opposing affidavit
120). The court below had before it the pleadings and
ibits attached thereto, the depositions of Paul T. F. Low
Philip H. Ching, and the Appellees' Answers to the Appel-
t's Interrogatories (R:120). Appellant's statement is
omplete and misleading, and therefore Appellees will
iew certain undisputed facts that were before the court
ow.

On February 14, 1963, the Appellees and the
ellant's predecessors in interest engaged in informal
cussions in Lahaina, Maui, State of Hawaii, relating to
purchase of approximately 144,192 square feet of Maui
ch property owned by the Appellees in Lahaina (R:2-3,44).

On the morning of February 15, 1963, the Appellees
w to Honolulu for further discussions of the purchase and
possibility of leasing this Maui beach property
3,44,77, Dep.Ching p.4).[1/] Appellees, not experienced in

Appellant states on page 3 of its Brief that on this date the negotiations were "completed for the lease". This is inaccurate, on the record, since the Appellees at no time have ever conceded that negotiations were ever completed to the extent that a meeting of the minds had been reached as to the terms and provisions of the proposed lease. However, on the present record, no genuine issue of any material fact arises because the court below, in effect, assumed for the purposes of its decision that negotiations were completed and that no contract resulted or could result from the alleged option and its alleged acceptance alone (R:105-107); A fortiori, if negotiations were not completed and there remained essential terms to be agreed on, then clearly the Appellees were entitled to summary judgment.

leasing of real property (R:92), were not represented by
nsel at either of the meetings (R:80) although during the
olulu meeting, the Appellant was represented by a member
the local bar (Dep.Ching p.2-8). It was this member of the
(acting under the directions and instructions of the
ellant's predecessors in interest) who hurriedly drafted
paper entitled "Option to Lease" (R:3,44, Dep.Ching p.5,10).

The document granted to the Appellant an "exclusive
on to lease" the above mentioned Maui beach property (R:8).
ellees understood that this grant prevented, during the
of the "exclusive option", the Appellees from negotiating
ease with any other person (R:84).[1/]

An essential and material provision of the "exclusive
on" is the following:

> "Said lease shall contain the standard provisions normally contained in a lease for similar property situate in the State of Hawaii together with the provision that the Lessor shall subordinate their fee to permit the Lessee to obtain financing which provision is by way of example, but not by way of limitation." (R:9)

A proper subordination provision in the lease was basic
essential to enable the Appellant to obtain for the
efit of both lessor and lessee the proper financing
a proposed 2-3 story, 200 unit "combination
tment hotel" project costing between $1,000,000 and

[1/] This is the obvious conclusion from the use of the word "exclusive" in the alleged option.

00,000 (Dep.Low p.9; Dep.Ching p.14,27,29). It was con-
d by the attorney acting for the Appellant at the time
he negotiations, that a subordination provision in a
iian lease is not a standard or usual provision (Dep.
g p.7,16).

On April 22, 1963, the Appellees extended the term
he exclusive option to August 1, 1963 (R:4,44-45).

Between February 15, 1963 and July 25, 1963, a
e was prepared by Mr. Dwight Rush, a member of the Hawaii
(Dep.Ching p.23). This lease was sent to California but
never submitted to the Appellees (Dep.Ching p.23).

Prior to July 25, 1963, the Appellees hired Mr.
ard Mirikitani, a member of the Hawaii bar, as their
rney (R:80). On or about that date, Mr. Frank Nunes from
California law firm of Nunes & Crews, Hayward, California,
onally delivered to the law offices of Mr. Mirikitani an
ecuted lease (R:13-36,85). This second lease contained
isions which are neither standard or usual provisions
ally contained in Hawaiian leases (R:4-5,45). The proposed
ors named in this lease were the Appellees (R:13), and the
osed Lessee was the Appellant (R:13). The lease was for
same term mentioned in the alleged option (R:8,13), at
same annual rental (R:8,13-14) with, however, a provision
iring the Appellees to join in a mortgage or deed of

---

he California lease tendered by the Appellant describes
he project as a "hotel or garden apartments" (R:24-25).

st securing a loan in a sum not exceeding ninety per
t (90%) of the value of the land and improvements (R:22).
s lease contained an option to purchase (R:32-33) which
not mentioned in the alleged option yet apparently was
cussed on February 15, 1963 (Dep.Ching p.24).[1/]

On July 26, 1963, the option was assigned to the
ellant (R:5,45) and on this same date the Appellant pur-
tedly exercised the alleged option by signing and
ivering to the Appellees a "Notice of Exercise of Option
Lease" (R:5,45).

On August 1, 1963, the alleged option expired
10).

On August 23, 1963, the Appellees formally advised
Appellant's local attorney that since no agreement had
n reached with the Appellant, the Appellees considered
alleged option null and void and tendered the "exclusive
ion" payment made by the Appellant (R:5,6-45).

On August 29, 1963, the complaint was filed
la-39). On September 11, 1963, the case was removed
the United States District Court for the District of
aii (R:40-42). On October 21, 1963, the Appellant filed
answer and counterclaim for specific performance (R:43-66).
exed to this counterclaim was a third proposed form of lease
pared by the Appellant (R:47-66). Appellant alleged that

[1/] Other examples of 'non-standard' provisions included in this lease were an extension clause and an arbitration clause (R:29-30,32).

s form of lease complied with the terms of the alleged
ion (R:46).

On October 25, 1963, the Appellant filed its first
ice of lis pendens (R:67-72). On November 16, 1964, the
ellees filed their amended reply setting forth the affir-
ive defense of the failure of all the documents to comply
h the Statute of Frauds, Chapter 190 Revised Laws of
aii 1955, as amended (R:96-98).

On January 5, 1965, the Appellees filed their
tion to Dismiss Counterclaim, or in the Alternative,
ion for Summary Judgment" (R:99-101). After the hearing
the motion the court below ruled orally on January 7,
5 that no contract to lease had been entered into because
the uncertainty and indefiniteness of its essential and
erial terms (R:105-109). On this same date, the Appellant's
orney offered in open court to waive the subordination
use (R:108) and after further briefing on the waiver
stion the court below on June 14, 1965 entered its written
ision granting the motion for summary judgment (R:114-118).

On June 30, 1965, judgment was entered which, among
er things, cancelled the lis pendens filed by the Appellant
October 25, 1963 (R:119-121). On the same date, the
ellant filed its notice of appeal (R:122-123) as well as
econd notice of lis pendens (R:124-129) which notice
been subsequently cancelled by the court below by the
ision dated November 2, 1965.[1/]

1/ For the convenience of the court, the Decision is set forth in Appendix A.

ARGUMENT

I

SUMMARY OF ARGUMENT

The alleged option to lease the Appellant seeks enforce in this action includes the following paragraph:

> "Said lease shall contain the standard provisions normally contained in a lease for similar property situate in the State of Hawaii together with the provision that the Lessor shall subordinate their fee to permit the Lessee to obtain financing which provision is by way of example, but not by way of limitation." (R:9)

The meaning of the above language is that a ovision that the Appellees would subordinate their e simple interest in the real property described in e alleged option would be included in the lease together th other non-standard provisions not mentioned and t to be negotiated.

The court properly held that the subordination ause as set forth in the option to lease is necessarily essential and material term thereof and as a matter law the above subordination language is so vague, definite and uncertain that it renders the alleged tion unenforceable. A subordination clause is

aningless without the determination of the maximum
ount of the loan, the interest rate of the loan, the
riod of the loan and the purpose to which the proceeds
the loan are to be applied. In order to enforce
e alleged option with the subordination provision
cluded, a court necessarily would have to include
rms of the subordination provision which terms were
t agreed to by the parties. The court below properly
ld that, as a matter of law, it could not make such an
reement for the parties.

The Appellant's contention that it is entitled
waive the subordination provision would still require
e court's enforcement of a contract that was not agreed
on by the parties and this the court below properly
fused to do. The court below determined that a
oper subordination clause would benefit both the
ssor and the lessee since the parties contemplated
e construction of a completed structure on the premises
be leased and the magnitude of the structure and the
ssor's reversionary interest therein were all tied to
properly negotiated subordination clause. The
pellant's waiver of an essential but not fully negotiated
rm of a contract furnishes no basis giving a remedy on
alleged contract which was not completed and hence not
nding on either party.

II

SUBORDINATION CLAUSE

Appellant's principal contention is that the language . . Lessor shall subordinate their fee to permit the Lessee obtaining financing . . ." is definite enough for specific formance of the alleged option because all this phrase means that the parties have agreed that the subordination of the ellees' fee interest will be without restrictions (Brief for ellant p.13).

This argument is invalid for two reasons: First,[1/] Appellant has lifted this phrase completely out of the con- t from the rest of the sentence in which it is used, thereby torting the obvious meaning that a provision subordinating fee would be included in the lease along with other non- ndard provisions not mentioned and yet to be negotiated, Second,[2/] as a matter of law, the subordination language is vague, indefinite, and uncertain that it renders the alleged ion unenforceable. Necessary elements of a subordination use are omitted, such as the maximum amount of the construc- n loan, the terms of the loan including when the loan would ome due, the rate of interest it would bear and the manner which the loan would be paid.

Before discussing these arguments, the Appellees l review briefly the principles of law necessarily considered the court below in its oral decision (R:105-107).

1/ This argument begins on page 15 of this Brief.

2/ See pages 17-31 of this Brief.

A. Statute of Frauds

If an option to lease is so indefinite and un-
rtain in its essential and material terms because future
gotiations are contemplated between the parties, then
der the Hawaii Statute of Frauds neither an action for
ecific performance nor an action for damages can be
intained. 1/ It is a basic requirement of this Statute that
e agreement must be sufficient, that is, the agreement
st contain all the essential and material terms of the
reement.

The court below by deciding that the subordination
nguage was vague and indefinite and could not be waived
one party because it was an essential and material term
the alleged option, concluded that as a matter of law
e alleged option was insufficient under the Statute of Frauds.

49 Am.Jur. Statute of Frauds § 353 (1943), states
e applicable principle:

> "The general rule is that the memorandum, in order to satisfy the statute, must contain the essential

---

Chapter 190 Revised Laws of Hawaii 1955, as amended, provides in part:

> "Certain contracts, when actionable. No action shall be brought and maintained in any of the following cases: . . .
>
> "(d) Upon any contract for the sale of lands, tenements or hereditaments, or of any interest in or concerning them; . . .
>
> "Unless the promise, contract or agreement, upon which such action is brought, or some memorandum or note thereof, is in writing, and is signed by the party to be charged therewith, or by some person thereunto by him in writing lawfully authorized."

terms of the contract, expressed with such certainty that they may be understood from the memorandum itself or some other writing to which it refers or with which it is connected, without resorting to parol evidence."

The annotator in Annot., 14 A.L.R.2d 621 (1950), titled "Sufficiency of memorandum of lease agreement to satisfy the Statute of Frauds, as regards terms and conditions of lease" summarizes the general rule by stating:

"'The parties must have reached final agreement upon all essential terms of a valid contract, without reservation of any such term for future negotiation, and those terms must be embodied in a writing.' In other words, the memorandum relied on to establish a lease agreement must embody all the essential and material parts of the lease contemplated to be thereafter executed with such clarity and certainty as to show that the minds of the parties had met on all material terms so as to effect a complete and valid lease, with no material matter left for future agreement or negotiation." (at 624)

Similarly, the court in 1130 President Street Corp. v. Bolton Realty Corp., 300 N.Y. 63, 90 N.Y.S.2d 58 (Ct. App.), 38 N.E.2d 16 (1949), states the rule:

"The requirements which this agreement must meet--that it may be enforced as a contract and satisfy the Statute of Frauds--are clear in theory and not peculiar to a contract for the lease of real property. The parties must have reached final agreement upon all essential terms of a valid contract, without reservation of any such term for future negotiation, and those terms must be embodied in a writing. . . ." (38 N.E. 2d at 18)

The answer to an anticipated argument that by the use of the words "essential terms", the courts simply mean agreement upon the property description, the term, the amount of rent, and the time and manner of payment, is

e following comment by the same annotator in Annot.,

A.L.R.2d, at 624:

> "And it should be particularly noted that although a memorandum may satisfy the statute by setting out with sufficient clarity all essential terms of a valid lease, if it goes further and shows that some other term or condition material to the lease, though not essential to a valid lease, has not been fully agreed upon by the parties but has been left for further negotiation or agreement, such additional matter may thereby render the memorandum insufficient under the statute."

e Hawaii Supreme Court in Francone v. McClay, 41 Haw. 72,

-79 (1955), has recognized and adopted this view:

> "Many authorities hold that there need be only a definite agreement as to the name of the parties to the lease, the extent and bounds of the property leased, a definite and agreed term, a definite and agreed price or rental, and the time and manner of payment. Where there are these essentials and no expectation of further provisions to be negotiated later, such a contract to lease is sufficiently definite for enforcement by a decree of a court of equity. . . .
>
> "However, the important element in the cases purporting to set forth the so-called essential elements as being only the names of the parties, a description of the property to be leased, the amount of rental, the terms of payment, the term and duration of the lease, is that there is no expectation of further provisions to be negotiated later."

the same effect see:

Rosenfield v. United States Trust Co., 290 Mass. 210, 195 N.E. 323 (1935);

Blackmore-Danzig Co. v. Silsbee, 131 Misc. 340, 225 N.Y.Supp. 767 (Sup.Ct. 1927); and

H. M. Weill Co. v. Creveling, 181 App.Div. 282, 168 N.Y.S. 385 (1917), aff'd without op. 119 N.E. 1048.

B. An option to lease which is incomplete and uncertain cannot be specifically performed.

It is without dispute (1 Williston, Contracts § 3?, . 107-111 (1957 ed.) that there cannot be an "offer" in e legal sense without sufficient definiteness there f, s at upon acceptance a court is able to give the offer ar act meaning. Since by definition an option is merely ar fer, an option cannot be accepted unless it contains "all e terms necessary for the required definiteness." (See merous cases cited by Williston loc. cit.)

It therefore follows that contracts, which are complete and uncertain, are not capable of being specifica.ly rformed.

25 R.C.L., Specific Performance § 17, "Certainty Contract Generally," states:

> "One of the fundamental rules respecting the specific performance of contracts is that performance will not be decreed where the contract is not certain in its terms. The terms must be complete and free from doubt or ambiguity, and must make the precise act which is to be done clearly ascertainable. A decree of specific performance may be entered where the contract is certain and complete, or contains provisions which are capable in themselves of being reduced to certainty, and from which the intention of the parties can be clearly ascertained, but such a decree will be denied if some of the terms of the contract are indefinite and uncertain or are left open for future determination by the parties."

The Hawaii Supreme Court, in Francone v. McClay, pra, recognized the general rule when it stated:

> "There is little or no conflict of authority upon the general principle that where

a contract is complete and certain as to the essential and material terms, parts and elements of a lease, specific performance will be granted; nor if the contract to lease or the negotiations of the parties affirmatively disclose or indicate that further negotiations, terms and conditions are contemplated, the proposed lease is considered incomplete and incapable of being specifically enforced." (41 Haw. at 78)

Similarly, in Mercer v. Payne & Sons Co., 115 b. 420, 213 N.W. 813, 818 (1927), the court stated:

"The rule appears to be, as deduced from the authorities, that a court of equity will not enforce a contract, unless it is complete and certain in all its essential elements, and the parties themselves must agree upon the material and necessary details of the bargain, and if any of these be omitted, or left obscure or indefinite, so as to leave the intention of the parties uncertain respecting the substantial terms, the case is not one for specific performance. It is not the function of a court of equity to make a contract for the parties, or to supply any of the material stipulations thereof. If any of the essential details are wanting a chancellor will not supply them in a decree for specific performance. . . ."

C. Definiteness of the provisions of an option to lease is determined either on the date the option is exercised or the date suit is filed.

The applicable rule is stated by the court in eving v. Vandover, 240 Mo.App. 117, 218 S.W.2d 175, 179 949):

"'Equity will determine the enforceability of a contract as to certainty, completeness and mutuality as of the date of demand for specific performance or at the time suit is filed rather than at an earlier date.'"

e also Heidner v. Hewitt Chevrolet Co., 166 Kan. 11, 199 2d 481 (1948).

. The proposed leasing agreement would have contained a subordination clause and other non-standard provisions.

By taking the phrase ". . . lessor shall subordinate their fee to permit the lessee to obtain construction financing . . ." out of context and thereby excluding the following phrase which provision is by way of example, but not by way of limitation", Appellant offers the tenuous argument that the parties merely intended an unrestricted subordination of the Appellees' fee interest (Brief for Appellant p. 12).

Because a subordination clause is not self-executing it requires creativity (see the subordination cases starting page 20 of this Brief), the obvious and only logical construction to be given to this language of the alleged pleading that the lease would contain "standard provisions" and non-standard provisions, an example of a 'non-standard' provision being a subordination provision. Nor did the parties intend to place any limitations on the number of non-standard provisions. Other 'non-standard' provisions were intended and were expected to be negotiated during the life of the "exclusive period". The lease would not be limited to a single 'non-standard' provision.

On or about July 25, 1975, Mr. Frank Nunes, the California attorney while in Honolulu, personally delivered to the Appellees' attorney a lease drafted by the law offices of Nunes & Crews, 967 "B" Street, Hayward, California

:13,36,85). Although this lease contained, among others, ovisions relating to an option to purchase, an extension d an arbitration clause, the alleged option is silent r ese provisions. Thus, these provisions are either andard[1/] or 'non-standard' provisions and in light of the pellant's admissions in its Answer that this lease c n- ined provisions which were neither standard nor usual ovisions normally included in Hawaiian leases (R:45), ese provisions are obviously the 'non-standard' provisions.

Appellees' position is that on the motion for summary dgment the court below had only to consider if there was genuine issue of material fact on whether the subordinati r ause tendered by Appellant (or any subordination clause) s or could be a standard provision "normally contained in lease for similar property situate in the State of Hawaii". e court below could and did, in effect, take judicial notice at there is no such standard clause used in Hawaii (R:1) d the syntactical structure of the Appellant's own alleged tion document supports, if it does not require this nclusion.

1/ Francone v. McClay, 41 Haw. 72, at 82 (1955), suggests what are standard or the usual and stereotype provisions contained in a lease, naming provisions relating to the payment of taxes, insurance and other charges, etc., repair, maintain fences, sidewalks, sewerage, drains, observe the rules and regulations of the board of health, keep the premises in repair, not to assign or mortgage without the consent of the lessors, etc.

The alleged option on its face not only required anticipated future negotiations between the parties on the n-standard' provisions.[1/] This being so, the alleged ion cannot as a matter of law be the basis for a claim, ce the court has nothing before it which in any manner embles a completed agreement. Since the alleged option ex- ed without the parties reaching an agreement on a lease, court below quite properly rejected the task of creating novo a leasing agreement for the parties (R:114-118).

E. As a matter of law, a subordination provision requires agreement on the conditions of the subordination.

Appellant irrelevantly argues that the court below has ed in entering judgment because the subordination clause tracted for is "clear, definite and unequivocal" and that clause contracted for is "wholly without restrictions" ief for Appellant p. 13). In effect, the Appellant is uing that the language of the option resulted in a con- ctual obligation on the part of the Appellees-lessors to ow a lien to be imposed on their fee simple title (1) for an efinite amount, (2) at an indefinite interest rate, (3) able over an indefinite period, (4) for indefinite financing

[1/] For cases showing that the tender of the lease in connection with an uncertain option is indicative of the necessity for additional negotiation as to material terms, see: Goldstine v. Tolman, 157 Wis. 141; 147 N.W. 7 (1914); McKnight v. Broadway Inv. Co., 147 Ky. 535, 145 S.W. 377 (1912), and Rosenfield v. United States Trust Company, 290 Mass. 210, 195 N.E. 323 (1935).

poses, (5) unrestricted as to type, kind, size and purpose
structure to be constructed, and (6) the proceeds of the
ancing from which subordination would be available without
trictions to the lessee for any purpose whatsoever. All
s the Appellant, in effect, says is embraced within the
ase "to permit the lessee to obtain financing".

To succeed in this contention, which would appear to
absurd on its face, Appellant would have to overcome two
urmountable obstacles: (1) Prove that this absurd meaning
intended by the language of the option [to do this counsel
the Appellant suggests that in some vague way by stating "in
n court on two occasions that it would provide experts to
tify at the trial of this matter that the clause had a
inite and ascertainable meaning as it stood" (Brief for
ellant p.13), this amounted to an offer of proof of facts
ch precludes the entry of summary judgment], and (2)
isfy the requirements of certainty of a contract. Appellant
ld have to prove that such a clause to be drafted and inserted
the 56 1/2 years lease was one of the "standard" lease
uses contracted for because it was contained in leases of
milar property situate in the State of Hawaii". No genuine
ue of fact is made out by this contention, and no trial is
uired by the rules of procedure to dispose of so tenuous a
ition.

It should be noted that the testimony which the
ellant refers to in Francone v. McClay, 41 Haw. 72 (1955),

testimony merely as to what are "usual" clauses specially enforced in that case. There, the contract was for ease of income producing apartment property, with improvements in place. The concept of subordination of the fee simple le for the purpose of "financing" was not in any manner olved.

If the vague language of the Appellant's Brief (p.13) intended to convince this court that an expert will be perted to testify as to what the phrase ". . . Lessor shall ordinate their fee to permit the lessee to obtain financing ." means, Appellant is asking an expert to substitute his gment on a matter of law for the judgment of the court ow. If the Appellant intends to put on expert testimony to ve that the subordination clause in a lease contract is a ndard clause [no such offer of proof appears on the record], ellant is offering to prove something which the court below icially noticed could not be proven and which this court on present record will not disturb.

Appellant mistakenly relies as "squarely in point" McCarty v. Harris, 216 Ala. 265, 113 So. 233 (1927). In t case, purchasers of real property filed a bill in equity require the sellers to sell and convey property. The tract contained the statement that the purchasers may put irst mortgage on the property. The seller appealed the ial of a demurrer, contending, among other things, that contract was rendered uncertain because the contract did specify the amount of the first mortgage. The court

sposed of this by holding that that provision was not
e essence of the contract to convey ". . . a mere subsidiary
rt of the agreement" (113 So. at 234). In the present case, the
urt below held, in effect, that the subordination of
e fee in a leasing transaction involving Lahaina, Maui
ach property was extremely essential and necessary for
e proper financing for the hotel-apartment project as well
protection for the value of the reversionary interest of
e Appellees, their heirs or assigns (R:105-106, and see
p.Low p.9,12).

Appellees contend that the subordination language
the alleged option is uncertain and indefinite as a matter
law.

A case squarely on point is Gould v. Callan, 127
l.App.2d 1, 273 P.2d 93 (1954). There, a buyer of property
ught specific performance of a written contract for the
nveyance of real property. The contract contained the
llowing subordination clause (273 P.2d at 94):

> "'The 2nd Trust Deed mentioned on page 1 hereof to provide for subordination on following basis: In the event the trustor [plaintiff] should erect a building on subject property at a total building cost of not less than $75,000.00 or more than $300,000.00, then Beneficiary agrees to subordinate said Trust Deed to the lien of a first trust deed not to exceed 60% of the true building cost. In the event of such subordination then the payments on said Second Trust Deed loan to be $400.00 or more per month, including 5% interest.'"

The lower court found that provision to be uncer-
in and indefinite. The appellate court, after citing the

eneral rules relating to definiteness, stated:

"The subordination provision is incomplete in its statement of the obligation to be secured by the first deed of trust. It is silent as to the amount of interest, the length of time it is to run, and the terms of payment. Gardner, a realtor who represented defendant in the transaction, testifying in behalf of plaintiff, stated that at the time the escrow instructions were executed it was understood the subordination agreement would be prepared at a subsequent date by defendant's attorney and he was to approve its final form; the length of time the new first deed of trust would be on had not been previously discussed; the terms and conditions were to be prepared in a form which would be acceptable to and insurable by the Los Angeles Title & Trust Company.

"If something is reserved for the future agreement of both parties, the promise can give rise to no legal obligation until such future agreement. Since either party, by the very terms of the promise, may refuse to agree to anything to which the other party will agree, it is impossible for the law to affix any obligation to such a promise. . ." (273 P.2d at 95)

The court concluded by stating:

"The failure of the subordination clause to state the amount of interest and the terms and conditions of payment of the obligation to be secured by the first deed of trust makes the contract uncertain and indefinite. The provisions are material and essential to a contract providing for a deed of trust as security for an obligation, and their absence is fatal to the claim for specific performance. The indefiniteness, uncertainty, and absence of all of the indicated material and substantial terms of the alleged contract justified the trial court in denying specific performance." (273 P.2d at 96)

The next case following Gould v. Callan was Roven . Miller, 168 Cal.App.2d 391, 335 P. 2d 1035 (1959). This as also an action for specific performance of a contract for ne sale of real property. The "Purchase Option Contract", ong and detailed in many respects, was set forth in toto n footnote 1 appearing on pages 1037 and 1038. That

ortion of this contract referring to a subordination

ause was (335 P.2d at 1038):

> "'"This Deed of Trust will be subordinate to a First Deed of Trust to secure a construction loan which will be placed upon the property by the Trustor, or his successors and assigns, given to a recognized Savings and Loan Association or bank for the purpose of securing a loan to be used for the construction of residences and improvements on said property. Beneficiary will issue a partial reconveyance for any specific lot number covered by this Deed of Trust upon the payment to the beneficiary of a sum equal in proportion to the number of lots secured by the Deed of Trust to the original amount of the note secured hereby plus 20% for each lot reconveyed. When the balance of the note secured by this Deed of Trust has been paid in full, beneficiary will issue a full reconveyance for the property still covered by the lien of this Deed of Trust."'"

Notwithstanding the extensive details provided in the Purchase Option Contract, the appellate court upheld the lower court's finding that the contract was indefinite, incomplete and uncertain because of the subordination clause, relying primarily upon Gould v. Callan.

The court's holding was as follows (335 P.2d at 1040-41):

> "In the instant case the subordination clause contained in the purchase option contract does not state the amount of the construction loan which would be placed on the property, nor any of its terms, nor when said construction loan would become due, nor the rate of interest that it would bear, nor the terms or conditions of the first deed of trust to secure said construction loan. These provisions are material and essential to a contract providing for a deed of trust as security for an obligation and their absence justified the trial court in denying specific performance of the contract."

One month after the Roven case, the California appellate court was confronted again with a subordination problem in Kessler v. Sapp, 169 Cal.App.2d 418, 337 P.2d 94

959). In that case, the buyers had entered into an reement to purchase from the sellers a parcel of unimproved operty. Upon the latter's refusal to convey the property, e buyers brought an action for specific performance, whereon the sellers sought declaratory relief and a quieting title. The court affirmed the lower court's finding at the contract was too uncertain to be binding because the indefiniteness of the subordination clause:

> "'. . . The Deed of Trust securing the above described Note shall contain the following Subordination Agreement: The Beneficiary on behalf of his or her heirs, administrators and assigns hereby agree and consent that during the life of said Deed of Trust the Trustors or their successors in interest may obtain a loan from a Bank, Insurance Company, Savings and Loan Association or Mortgage Company, securing a note for construction and/or permanent financing to be secured by a deed of trust which will be and remain at all times a lien on the property herein described and superior to the lien of this deed of trust. As a matter of record only, the Seller agrees to accept the Deed of Trust securing the above described Note on subject property described as individual parcels or lots instead of acreage if the buyer has completed subdivision and obtained correct legl description describing the property by Lot and Tract. The Seller agrees to subordinate the Deed of Trust which will become a second deed of trust to a first trust deed to be filed concurrently or after close of escrow, and said first trust deed not to exceed in the amount equal to $6.50 per square foot exclusive of garages, stairways and porches.'" (338 P.2d at 36)

In 1960, the California court was again concerned th the indefiniteness of a subordination provision in an tion to purchase. In Wright v. Fred Heyden Industries, Inc., Cal.Rptr. 392 (Cal.App. 1960), the court, in responding to e question of indefiniteness of an agreement to convey

sed for the first time on appeal, held the following sub-
ination provision to be indefinite (6 Cal.Rptr. at 393-
):

"'The trust deed hereinabove provided for' the contract continued 'shall contain provisions permitting Buyer to subordinate and Owner agrees that the trust deed may, at the option of Buyer, be subordinated to loans for the purpose of improving the property covered by said deed of trust by the subdivision thereof and the construction on the lots produced as a result of such subdivision of houses and related improvements and shall further provide that upon the sale of each house and lot thus produced and improved, Owner will promptly, upon the request of Buyer, place in the escrow in which such house and lot is being sold by Buyer to a third person, a partial release of said deed of trust, which partial release shall remove from said house and lot the lien of such deed of trust, together with instructions to said escrow that such partial release may be delivered to the purchaser of such house and lot upon said escrow being able to deliver to Owner a sum equal to the full amount of the note of Buyer as hereinbefore described divided by the number of lots produced by the subdivision of the usable part thereof by Buyer.'"

The court held (6 Cal.Rptr. at 394):

"It will be noted that nowhere in the provisions quoted--and, we add, in no part of the contract not quoted--is there any statement made as to the maximum amounts of the loans, the lengths of time they may be made to run, in what manner they are to be paid, what, if any, interest they are to bear, or as to other conditions of importance in determining to what burdens the property being sold and scheduled to be held in trust to secure the buyer's obligation to the seller, is to be subjected. Provisions of subordination striking similar to the above, were under review in two fairly recent cases decided by this court: Gould v. Callan, 1954, 127 Cal.App.2d 1, 273 P.2d 93 and Kessler v. Sapp, 1959, 169 Cal.App.2d 818, 338 P.2d 34. . . ."

In Conely v. Fate, 227 Cal.App.2d 418, 38 Cal.Rptr.
3 (1964), the court held that a deposit receipt which implied
at a purchase money trust deed would be subordinated to a

ilding loan was uncertain because the receipt did not
ate what type of structure or structures would be con-
ructed on the property or the amount of the building loan,
lying on Gould v. Callan.

A recent decision on a subordination provision
Magna Development Company v. Reed, 228 Cal.App.2d 230,
Cal.Rptr. 284 (1964). There, the court was involved
th the identical question and procedure for raising that
estion which confronted the court below. The question on
peal was whether the lower court was justified in granting
notion for summary judgment. This, in turn, raised the
estion "whether a subordination clause in an agreement for
e sale of real property is uncertain as a matter of law"
9 Cal.Rptr. at 286). The appellate court affirmed the
cision of the lower court stating that (39 Cal.Rptr. at 290):

> "[W]hen something is reserved for future agreement [terms of the subordination clause] of both parties, the promise [to include the clause] can give rise to no legal obligation until such future agreement. 'Since either party, by the very terms of the promise, may refuse to agree to anything to which the other party will agree, it is impossible for the law to affix any obligation to such a promise.'"

It makes no difference whether the option refers
the purchase or leasing of real property, or whether the
tter is decided outside of the State of California. The
w York court, in Kusky v. Berger, 225 N.Y.S.2d 797 (1962),
f'd without opinion, 249 N.Y.S.2d 858 (Sup.Ct., App.Div.

64), was concerned with an action seeking specific per-
rmance of an agreement to lease containing a subordin-
ion clause. There, as here, was an agreement or option
lease real property. Although the court does not set
rth in its opinion the exact language of the subordination
ause, the court stated:

> ". . . It [agreement to lease] further obligates the Lessor to subordinate the said property to a first mortgage lien to be obtained by the Lessee in an amount not exceeding specified percentages of the cost of the building depending on the maturity date of the mortgage and sets forth elaborate provisions for refinancing and ultimate termination of all real estate mortgages not later than 14 years preceding termination of the lease. It requires that any mortgage to which the lease is to be subordinated be obtained 'from a banking or Savings & Loan Association or insurance institution licensed to do business in the State of New York.' It requires that all 'mortgages after the first refinancing must be fully self-liquidating', but makes no provision at all concerning interest rate of any mortgage." (225 N.Y.S.2d at 798)

The lessees brought an action for specific perform-
ce and were met with a motion to dismiss by the lessor
ising the legal insufficiency of the complaint. In grant-
g the motion to dismiss, the following portion of the
inion is pertinent, as well as support for the decision of
e court below (225 N.Y.S.2d at 799):

> "The 'material element' omitted in Willmott was the interest and amortization to be provided in the purchase money mortgage. While no New York case has been found dealing with interest in a subordination clause, as distinct from interest in a purchase money mortgage, as the missing element, the interest rate of a mortgage to which a lease is to be subordinated would have material bearing on the lessee's ability to carry on his business, and must be

considered a 'material element,' Gould v. Callan, 127 Cal.App.2d 1, 273 P.2d 93. True, in the purchase money mortgage cases, the courts will imply that interest is at the legal rate and that the mortgage is to be payable on demand, . . . or that the mortgage is to have the same interest rate and maturity date as an existing one, . . . unless the parties by expressly leaving such missing elements to negotiation negate such implication or inference, . . . On the facts of the present case there can be no such implication or inference, however, for the mortgage is to be obtained by plaintiff or his assigns from a banking or insurance institution, a totally different situation, of course, from that of a seller taking back a purchase money mortgage. Were plaintiff's assignee a corporation, as is the normal practice in real estate transactions, there would be no legal limit on the rate of interest, . . . Having both omitted the interest rate from the subordination clause and included a right of assignment by plaintiff, the parties have created an hiatus making a specific performance decree impossible." [citations omitted]

The applicable principle of law emerging from the regoing decisions[1/] and adhered to by the court below in s oral decision (R:105-107) is that whenever an agreement fers to subordination the terms and conditions of the sub- dination clause set forth in the option must be spelled out complete and extensive detail if there is to be a binding d enforceable agreement between the parties. Accordingly,

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Appellant's futile attempt to distinguish the California cases is based on a claim that the cases turn on a California statutory provision that a purchaser of property has no personal liability under a purchase money mortgage. This point has never been raised or relied on in any of these California cases even though the courts are repeatedly confronted with the subordination cases. The minimum requirements of a subordination clause would appear to be, at least, agreement upon the maximum amount of the construction loan both as to principal and interest and a reference to what terms would be required by the lender. See Stockwell v. Lindeman, 229 Cal.App.2d 750, 40 Cal.Rptr. 555 (1964).

e court below properly held the subordination language
the present action to be uncertain, vague, and indefinite,
d thus incapable of being specifically enforced or the
sis for an action for damages.

Appellees offer the following cases to demon-
rate the rationale and reasonableness of the principle of
w recognized in the foregoing cases. The cases that the
pellees could offer in support of the rationale of the
al decision of the court below are almost numberless.

H. M. Weill Co. v. Creveling, 168 N.Y.S. 385
up.Ct., App.Div. 1917) aff'd 119 N.E. 1048 . The court
ld a memorandum vague which provided for rent at a given
ntal and then rent for "11 years at a reappraisal of 5 per
nt" on the grounds that the language underscored did not
dicate what was to be reappraised. The court also held
rtain language to improve the property to the extent of
less than $10,000.00 as indefinite and uncertain because
ere was nothing to show when this expenditure would be
de or the character of the improvement.

Palombi v. Volpe, 226 N.Y.S. 135 (Sup.Ct., App.
v. 1927, aff'd 163 N.E. 607). There, the court held that
essential term had been left open for further negotiations
a provision in an alleged contract to lease which pro-
ded for "an opening or passway through the hall of the
use." The court held this language was too indefinite
constitute an agreement because it was impossible to tell

ere the opening was to be located.

Gordon v. Siegel, 125 N.Y.S.2d 862 (Sup.Ct.), dified on other grounds, 132 N.Y.S.2d 437 (1953). In that case a morandum of an agreement for the leasing of property ferred to the construction of a supermarket building. e court held this provision indefinite and indicating e necessity of further negotiations between the parties as the size, specifications and the cost of the building. e court further held that the type and size of the structure re material since the structure was to revert to the lessor the end of the term of the lease.

American Mining Co. v. Himrod-Kimball Mines Co., 4 Colo. 186, 235 P.2d 804 (1951). In that case, the court ld a contract incomplete which provided for the payment of yalties of certain percentages of the net return on grounds at the agreement did not state the method of calculating ch percentages or the time or manner of payment.

Colorado Corp. v. Smith, 121 Cal.App.2d 374, 263 2d 79 (1954). There, the court held a provision in a ntract relating to the construction of certain residences too vague and uncertain making the entire contract unen- rceable in equity. The exact language in the agreement ld uncertain was "the buyer herein agrees to construct at ch time as he chooses residences of not less than 1200 uare feet, each on the parcels facing on Gault Street." 63 P.2d at 80)

Chatham-Trenary Land Co. v. Swicart, 220 Mich.

', 189 N.W. 1000 (1922). In that case, an agreement
ovided that the defendants were obligated to pay for
)00 acres of land each year. The agreement did not pro-
de a way for selecting the parcels of land to be sold.
e court denied specific performance on the basis that such
provision was ambiguous and incapable of being specifi-
lly performed, holding that the parties should have stated
early the manner of executing provisions of the contract.

Andreula v. Slovak Gymnastic Union Sokol Assembly
. 223, 138 N.J.Eq. 260, 47 A.2d 878 (1964), aff'd, 140
J.Eq. 171, 53 A.2d 191 (1947). There, the court, in
nying specific performance of an agreement, held a pro-
sion in a lease providing that "the tenant herein shall
ve the first option to purchase said premises" (47 A.2d
878) as being too uncertain for failing to provide a
andard for determining price.

Sweeting v. Campbell, 8 Ill.2d 54, 132 N.E.2d 523
956). In that case, a contract relating to the financing
mortgage failed to provide for the maturity dates of the
rst and second mortgages. The court held the agreement
certain and denied specific performance of the contract.

Howard v. Beavers, 128 Colo. 541, 264 P.2d 858, 859
954). There, an agreement for the exchange of properties
ovided that one of the parties would "convey back unto the
rty of the second part a mortgage on the property hereinabove
scribed as the East 120 acres . . . for $14,800.00 . . ."
64 P.2d at 859). The court held that this language of

ıe contract concerning the terms of the mortgage made
ıe contract incomplete and therefore unenforceable.

To the same effect see:

Realty Improvement Co. v. Unger, 141 Md. 654, 119 Atl. 450 (Md.App. 1922);

Williams v. Manchester Building Supply Company, 213 Ga. 99, 97 S.E.2d 129 (1957); and

Cases cited in Annot., 60 A.L.R.2d 251 (1958).

III

WAIVER

Appellees have shown that the subordination pro-
ısion is an essential and material term of the alleged
ɔtion to lease and that the uncertainty of the clause
enders the alleged option invalid and unenforceable as a
atter of law. The Appellant argues that if the subor-
ınation provision is uncertain, the Appellant is entitled
ɔ "waive" the provision thus eliminating both the subor-
ınation provision and the resulting uncertainty from the
lleged option.

In Magna Development Company v. Reed, 228 Cal.App.
d 230, 39 Cal.Rptr. 284 (1964) (discussed at 25, supra),
ıe court was faced with the uncertainty of a subordination
rovision in a purchase agreement coupled with willingness
f one of the parties to waive this provision in an attempt
ɔ enforce the purchase agreement (The waiver was actually
et forth in the counteraffidavit of the plaintiff to

fendant's motion for summary judgment and supporting fidavit). The court held as follows (39 Cal.Rptr. at 204):

> "Plaintiff also argues that even if the subordination clause is uncertain as a matter of law, it has eliminated the uncertainty by waiving the benefit of the clause. . . . The attempted waiver is ineffective for two reasons. . . . Secondly, if a party were permitted to waive defective provisions going to the essence of a contract, the court, in effect, would be allowing the unilateral creation of a new, different contract. A party to a contract cannot erase uncertainty therefrom by waiving such uncertainty and thereby restore its contractual validity."

milarly, in Roven v. Miller, 166 Cal.App.2d 391, 335 P.2d], 335 P.2d 1035 (1959) (discussed at 2., supra), where e optionee attempted to cure the defect of an indefinite bordination provision by waiver of the provision, the court ld that the option had expired prior to the offer of waiver 35 P.2d at 1041). Appellant does not cite any case involv- g the waiver of an uncertain subordination provision.

One group of cases [1] (hereinafter called

Neely v. Broadstreet Nat'l Bank, 1 F.Supp. 839 (D.N.J. 1936);

Eppstein v. Kuhn, 225 Ill. 115, 80 N.E. 86 (1907);

Wright v. Houdaille-Hershey Corp., 321 Mich. 21, 31 N.W. 2d 845 (1948);

Torelle v. Templeman, 94 Mont. 149, 21 P.2d 61 (1933);

Jasper v. Wilson, 14 N.M. 482, 94 P. 951 (1908);

Prilik v. Goodman, 111 N.Y.S.2d 916 (S.Ct. 1952).

iver of performance cases) cited by the Appellant involves tuations analogous to that in Koon v. Maui Dry Goods and ocery Company, Ltd., 30 Haw. 313 (1928) (brief for pellant p.20), where the plaintiff brought a suit for the ecific performance of an agreement for the assignment of a ase. The Hawaii court recognized that full performance of e contract could not be specifically decreed since the fendant-lessee was unable to obtain a release from a sub-ssee. The plaintiff was held to be entitled to specific rformance in part and to an abatement in the purchase price damages for defendant's failure to perform. An example such a waiver in the factual context of the instant case uld have arisen if a valid contract to lease had been eated with the terms of the subordination clause definitely t forth, and then the Appellees were unable to perform cause a pre-existing lien on the property prevented the bordination of the fee as agreed upon by the parties. The pellant then would be in a position to specifically enforce e contract to lease, waiving the Appellees' failure to mpletely perform.

The Appellant assumes throughout its brief that e alleged option to lease ripened into a valid contract n all its terms save one" (Brief for Appellant p.25), and s argument is based upon that premise. Not only is the emise thus assumed the very issue to be decided in this

se but all the waiver of performance cases cited by the
pellant deal with contracts that are valid, binding and
rtain in all their terms, the only problem being whether
e terms are specifically enforceable or whether equity is
e proper remedy.

The Appellant cites a second group of cases[1/] (hereinter called deferred payment cases) involving contracts or tions for the purchase of real property which were held ecifically enforceable by the purchaser where a provision r deferred payment was indefinite but the purchasers offered ll payment of the purchase price in cash. However, in all e deferred payment cases the waiver was either made within e time period allowed in the contract or the contract was lent as to time. In the instant case, the date of expiraon of the alleged option was August 1, 1963 and the pellees made their offer of waiver in open court 17 months ter the time to exercise the option expired, and 14 months ter their own answer and counterclaim for specific perfor-

1/ Morris v. Ballard, 16 F.2d 175 (D.C.Cir. 1926);
Blanton v. Williams, 209 Ga. 16, 70 S.E.2d 461 (1952);
Trotter v. Lewis, 185 Md. 528, 45 A.2d 329 (1946);
Levine v. Lafayette Bldg. Corp., 103 N.J.Eq. 121, 142 Atl. 441 (1928);
Haire v. Patterson, 63 Wash.2d 282, 386 P.2d 953 (1963);
Hubbell v. Ward, 40 Wash.2d 779, 246 P.2d 468 (1952).

nce in this action. No case has been cited or discovered
ere a court has allowed a waiver of an essential term at
ch a time.

It is the Appellees' contention that the uncer-
inty of an essential term makes the alleged option void
d unenforceable under any circumstances but, assuming for
e sake of argument that the alleged option to lease was
pable of being exercised, the question is what rights
re created in the Appellant by its delivery of notice of
ercise on July 26, 1963 (R:5,45). The only possible result
a valid exercise of the option would be an executory
lateral contract to lease binding on both parties.
wever, the Appellant even after its notice of exercise,
s never been bound to execute any lease since it has been
ee at all times to insist upon a subordination provision
which provision is by way of example, but not by way of
mitation") absolutely satisfactory to itself. In view of
e fact that the Appellant has never been bound by a promise
accept a lease granted by the plaintiffs, a bilateral
ntract binding upon both parties could not have resulted
om the defendant's exercise of the option. It seems clear
at if no bilateral contract was created by August 1, 1963,
e date of expiration of the option, the option was not
fectively accepted and is deemed rejected as a matter of

aw.[1] Time is of the essence in an option which expressly efines the duration of the offer. 1A Corbin, Contracts 273 (1963) states:

> "If the time for acceptance of an ordinary offer is expressly limited by the offeror, acceptance must take place within that time or not at all; time is of the essence. The same is true of an offer that has the form of an option contract."

In effect, the Appellant is contending that it had continuous option for an indefinite period from August 1, 963 to waive the subordination provision and accept the ffer to contract to lease without the provision, even hough such provision was necessary for the protection of essor's interests. The Appellant understandably cites no uthority for such a contention.

The decisions in the deferred payment cases are ased upon the assumption that the provision being waived is benefit only to the party seeking specific performance. he Appellant admits that the subordination clause in this ase might be of some benefit to the Appellees (Brief for ppellant p.28), but the Appellant requests the court to hange the terms of the alleged option by eliminating the ubordination clause on the grounds that the probability of enefit to the Appellees is based upon speculation. This precisely what the court in Magna Development Company v.

---

[1] Failure to accept during the term of the option amounts to a rejection. 55 Am.Jur. Vendor and Purchaser, p.508, § 39.

ed, supra, and the court below declined to do because the words of the court below (R:118):

> "If the waiver were here sanctioned, this court would be creating a new and different contract from that which both parties attempted to make."

e Appellant argues that unless the benefit of the subor-nation clause to the Appellees can be shown with certainty e Appellant should be allowed to waive the clause at any me.

It is obvious that the Appellees contemplated that ey would receive a benefit by having a completed structure their premises through the device of a properly negotiated bordination clause and the court below properly refused to sume that this clause was of no benefit to them. The urt below recognized that a subordination provision in lease is normally one of the factors assuring that the ased property will be developed to its highest and best e to the substantial benefit of the property owner. As ated by the court below (R:117):

> "The term of the lease was to be 56 1/2 years. If a building of x value were placed thereon, it might be completely depreciated by the time the lease expired, whereas if a building of y value were built thereon, it might still be of great value to the lessor at the termination of the lease. The difference between an x or y building might well be the difference between subordination and no subordination of the fee, and in that difference the plaintiff [Appellees] had an obvious interest and potential benefit."

The Appellant argues that the court should eliminate

e subordination provisions since the courts in the deferred
yment cases eliminated terms of payment in spite of the
mote possibility that the sellers could have derived some
nefit from the extension of credit. With one possible
ception[1/] the provisions of the contracts involved in the
ferred payment cases permitted, either expressly or by
plication, the cash payment of the balance of the purchase
ice and the courts were not in the position of having to
ange the terms of the agreements involved. The distinction
s noted by the court below as follows (R:116):

> "The cases cited by the defendant [Appellant] are in accord with its contention that a vendee may waive his conditional right, which waiver, if allowed, thereafter leaves the contract an enforceable obligation within the ambit of its own terms as agreed upon by the parties."

The exclusion of the subordination provision urged
the Appellant would not leave the alleged option within the
bit of its own terms as agreed upon by the parties. It is
teworthy that the Appellant concludes the waiver section of
s brief with offering, in effect, to negotiate the terms of
e subordination provision with the Appellees ("by offering
waive only so much thereof as appellees desire" (Brief for
pellant p.31)). The Appellees submit that negotiation of
alteration as to the terms of the subordination provision
exactly what the alleged option to lease contemplated, and
at the summary judgment on the "illusory contract" was
operly entered.

1/ See Levine v. Lafayette Bldg. Corp., 103 N.J.Eq. 121, 142 Atl. 441 (1928). The New Jersey rule is clear, however, that a belated waiver in open court as attempted in the instant case would not be tolerated. 142 Atl. at 449.

IV

AN ACTION FOR DAMAGES IN LIEU OF SPECIFIC PERFORMANCE CANNOT BE MAINTAINED UNDER THE STATUTE OF FRAUDS.

Appellant maintains that the court below erred in awarding damages to the Appellant for the breach of the leged option (Brief for Appellant pp.32-34). Under the waii Statute of Frauds, however, "no action" can be ought if the documents relied upon for the agreement are sufficient under that statute.[1/]

By contending that the Appellant is entitled to an ard of damages, the Appellant would have to concede that the leged option is not sufficiently definite or complete in terms (including, of course, the subordination clause) to specifically enforced. Since the subordination clause was essential term, a fortiori the contract did not come into stence to be the basis for a damage action.

The waiver by the Appellant[2/] of the subordination vision in order to "eliminate any possibility of difficulty h respect to damage computation" cannot now be made the basis a damage action. Appellant cannot waive an essential

---

1/ Revised Laws of Hawaii 1955, as amended, § 190. 49 Am.Jur. Statute of Frauds, § 539 states: "It is a general principle that an invalid or unenforceable contract forms no basis for an action for damages occasioned by the breach of any obligation attempted to be imposed thereby."

2/ Brief for Appellant p.33.

m (simply for alleged ease in damage computations) and
ll have a contract remaining for a claim for damages.

The court below's determination that a proper sub-
lination clause was for the benefit of both lessor and lessee
a clear inference from the undisputed facts. The parties
ntemplated the construction of a complete structure on the
sed premises. The magnitude of the structure and the
sor's reversionary interest in the completed structure
all tied to a properly negotiated subordination clause,
ch negotiation was also contemplated by the parties.
ellant's waiver of an essential but not fully negotiated
m of a contract furnishes no basis giving a remedy for an
eged contract which was not completed, and hence not
ding on either party.

V

LIS PENDENS CANNOT BE FILED IN AN ACTION PENDING IN THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF HAWAII INVOLVING REAL PROPERTY.

Appellant argues that the court below also erred in
celling its notice of lis pendens filed October 25, 1963
the grounds that a lis pendens does not expire upon the
uance of a judgment but only upon the final determination
the case, including the outcome of any appeals.

A notice of lis pendens in a federal action cannot
perly be filed in a state recording office until the state
pts the necessary laws contemplated by 28 U.S.C.

1964,[1/] i.e., a specific statute authorizing a notice of action concerning real property pending in a United States District Court to be recorded in the same manner as required of a notice of an action concerning real property pending in a state court.

The decision of the court below dated November 2, 1965 is disparitive of this point:[2/]

> "The legislative history of the present R.L.H. 1955, Section 230-42, shows that the Senate Judiciary Committee reported on H.B. 181 of Hawaii's 1927 legislature, creating a new section of the Revised Laws of Hawaii 1925 relating to notice of pendency of action:
>
> > 'The purpose of this Bill is to require the filing in the office of the Registrar of Conveyances a notice of the pendency of any action brought in any Circuit Court [of the Territory] involving the title to real estate.' (Emphasis added.)
>
> "The United States District Court for the Territory of Hawaii had long before been established by Congress.

[1/] 28 U.S.C. § 1964 provides:

"Constructive notice of pending actions

"Where the law of a State requires a notice of an action concerning real property pending in a court of the State to be registered, recorded, docketed, or indexed in a particular manner, or in a certain office or county or parish in order to give constructive notice of the action as it relates to the real property, and such law authorizes a notice of an action concerning real property pending in a United States district court to be registered, recorded, docketed, or indexed in the same manner, or in the same place, those requirements of the State law must be complied with in order to give constructive notice of such an action pending in a United States district court as it relates to real property in such State."

[2/] See also Appendix A.

"United States Senate Report No. 2131 on H.R. 7306 -- which eventually became 28 U.S.C. § 1964 -- stated:

> 'The purpose of the proposed legislation is to provide that notice of an action . . . [lis pendens] with respect to real property, pending before a United States district court, must be recorded if the State law so provides, in order to be considered constructive notice to others that such action is pending.
>
> * * * *
>
> 'The legislation contains two requirements: (1) the State law must require that notice of local suits in State courts (as distinguished from Federal courts) be registered [etc.]; and (2) the State law must also expressly authorize notice of Federal suits to be registered, indexed, etc., in the same manner as notices in State courts. These provisions . . . will not become effective within a State until it has expressly authorized such registering, . . . etc. . . . .
>
> 'In order that Federal litigants may obtain the same protection as is offered in State court actions, the bill provides that the State law authorizing the registering, etc., of Federal notices must be the same as that for registering of State notices in State court actions . . . .'

Anent the same bill, the Assistant Director of the Administrative Office of the United States Courts advised the Committee on the Judiciary of the House of Representatives:

> '[W]ith respect to notice of the institution of suits in the Federal district courts concerning real property by providing that they should not have the effect of lis pendens unless registered, recorded, docketed, or indexed as the State law provides, if in fact the State law does provide for such registering, recording, docketing, or indexing of such Federal suits.'

The Deputy Attorney General writing to the same committee also advised that committee that H. R. 7306 did not apply unless (1) the State already had a lis pendens

statute and (2) the laws of that State also provided for similar recording of notice of an action concerning real property pending before a United States district court in such State. The Assistant Secretary of the Interior, writing to the same committee, likewise advised that same committee to the same effect.

"From the legislative history of both the State and Federal acts, it becomes clear that Hawaii's lis pendens statute does not apply to suits pending in the United States district court, cf. King v. Davis, 137 Fed. 222, 240 (Cir.Ct. Va. 1905), and the registrar of the Bureau of Conveyances had neither the duty nor the legal power to accept and file the same under Section 343-47, R.L.H. 1955, since the lis pendens referred to in that section, being strictly a creature of the Hawaiian statutes, could and did refer only to cases filed in the circuit courts in the State of Hawaii."

Accordingly, the judgment cancelling the lis penders October 25, 1963 was proper in all respects (R:119-121).

VI

CONCLUSION

For the reasons stated herein, the judgment should in all respects be affirmed.

Respectfully submitted,

J. RUSSELL CADES

WILLIAM M. SWORE

WILLIAM M. SWORE

Attorneys for Appellees

Of Counsel

SMITH, WILD, BEEBE & CADES

CERTIFICATE

I certify that, in connection with the prepara-
on of this brief, I have examined Rules 18 and 19 of
e United States Court of Appeals for the Ninth Circuit,
d that, in my opinion, the foregoing brief is in full
mpliance with those rules.

J. Russell Cades

J. RUSSELL CADES

WILLIAM M. SWOPE

WILLIAM M. SWOPE

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF HAWAII

EPH TAU TET HEW and HELEN ONA HEW, husband and wife, RGE TAN and SHIZUKO RUTH TAN, band and wife,	)	
Plaintiffs,	)	
v.	)	CIVIL NO. 2192
LAHAINA-MAUI CORPORATION, alifornia corporation,	)	
Defendant.	)	

DECISION ON PLAINTIFFS' MOTION TO REMOVE LIS PENDENS

Plaintiffs, owning real property on Maui, in 1963 ecuted an option to lease the property to defendant's decessors in interest. Before the expiration of the ion, defendant signed and delivered to the plaintiffs a ice of exercise of the option to lease. Within one th thereafter, plaintiffs informed defendant that such ion to lease was null and void, and on August 29, 1963, intiffs filed a complaint in the State court, seeking a cellation of the option and a declaration that it was l and void. Thereafter, defendant had the case removed this court on the grounds of diversity, and on October 21, 3, filed a counterclaim seeking specific performance of ease in the form attached to the counterclaim.

On October 25, 1963, defendant, purporting to do under R. L. H. 1955 Section 230-42, recorded a notice of

e pendency of the suit, i.e., lis pendens, in the Bureau Conveyances, State of Hawaii. A similar notice was filed th the assistant registrar of the Land Court of the State Hawaii under Section 342-78, R.L.H. 1955, since a portion the land involved was registered therein.

Thereafter, ruling upon plaintiffs' motion for mmary judgment, on June 30, 1965, this court entered judg- nt in favor of plaintiffs and against defendant, and dered the lis pendens removed.

Defendant gave timely notice of appeal, and on ne 30, 1965, filed a new lis pendens in the Bureau of nveyances. On September 9, 1965, a notice of motion to move lis pendens, or in the alternative posting a super- deas bond, was filed by the plaintiffs, and thereafter the me was argued and submitted.

As indicated from the motion, the defendant has ver filed a supersedeas bond under F.R.Civ.P. 62, in der to obtain a stay, and admittedly is relying upon the s pendens to effect the same result -- without cost to e defendant.

Plaintiffs urge that a lis pendens notice of this deral action cannot properly be filed in the Bureau of nveyances because the State of Hawaii does not have a law ch as is contemplated by 28 U.S.C. § 1964, i.e., a specific atute authorizing a notice of an action concerning real operty pending in a United States district court to be

orded in the same manner as required of notice of an
ion concerning real property pending in the State court.
intiffs also urge that the operation of the notice of
pendens filed June 30, 1965, is preventing the plaintiffs
m dealing with or developing their property as is their
ht to do after the judgment in their favor, in the
ence of a supersedeas bond. Defendant urges (1) that
s court has no power to cancel the lis pendens of June
1965; (2) that even if plaintiffs contention regarding
effect of 28 U.S.C. § 1964 were correct, all that this
rt could do would be to rule that such filing of a lis
dens was unnecessary; and (3) that notice must be filed
h the Land Court under Section 342-78, R.L.H. 1955.

The legislative history of the present R.L.H.
5, Section 230-42, shows that the Senate Judiciary
mittee reported on H.B. 181 of Hawaii's 1927 legislature,
ating a new section of the Revised Laws of Hawaii 1925
ating to notice of pendency of action:

> "The purpose of this Bill is to require the filing in the office of the Registrar of Conveyances a notice of the pendency of any action brought in any Circuit Court [of the Territory] involving the title to real estate." (Emphasis added.)

The United States District Court for the Territory
Hawaii had long before been established by Congress.

United States Senate Report No. 2131 on H.R.
6 -- which eventually became 28 U.S.C. § 1964 --
ted:

"The purpose of the proposed legislation is to provide that notice of an action . . . [lis pendens] with respect to real property, pending before a United States district court, must be recorded if the State law so provides, in order to be considered constructive notice to others that such action is pending.

* * * *

"The legislation contains two requirements: (1) the State law must require that notice of local suits in State courts (as distinguished from Federal courts) be registered [etc.]; and (2) the State law must also expressly authorize notice of Federal suits to be registered, indexed, etc., in the same manner as notices in State courts. These provisions . . . will not become effective within a State until it has expressly authorized such registering, . . . etc. . . . .

"In order that Federal litigants may obtain the same protection as is offered in State court actions, the bill provides that the State law authorizing the registering, etc., of Federal notices must be the same as that for registering of State notices in State court actions . . . ."

nt the same bill, the Assistant Director of the Adminis-

tive Office of the United States Courts advised the

mittee on the Judiciary of the House of Representatives:

"[W]ith respect to notice of the institution of suits in the Federal district courts concerning real property by providing that they should not have the effect of lis pendens unless registered, recorded, docketed, or indexed as the State law provides, if in fact the State law does provide for such registering, recording, docketing, or indexing of such Federal suits."

Deputy Attorney General writing to the same committee

o advised that committee that H. R. 7306 did not apply

ess (1) the State already had a lis pendens statute and

the laws of that State also provided for similar record-

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same under Section 343-47, R.L.H. 1955, since the lis
dens referred to in that section, being strictly a
ature of the Hawaiian statutes, could and did refer only
cases filed in the circuit courts in the State of Hawaii.
h the notice of lis pendens filed October 25, 1963,
ore the judgment was rendered in the instant case, as well
the lis pendens filed on June 30, 1965, filed after
gment in the instant case, were improperly and illegally
ed. We need, however, concern ourselves at this time
y with that filed on June 30, inasmuch as this court as
t of its judgment cancelled the first lis pendens.

Defendant also urges that inasmuch as a portion of
property affected by the instant action has been regis-
ed in the Land Court of the State of Hawaii under Section

1/ For the legislative history of H.R. 7306, see United
tes Code, Congressional and Administrative News, 85th
gress--Second Session 1958, Volume 2, pp. 3654-3658.

"The purpose of the proposed legislation is to provide that notice of an action . . . [lis pendens] with respect to real property, pending before a United States district court, must be recorded if the State law so provides, in order to be considered constructive notice to others that such action is pending.

* * * *

"The legislation contains two requirements: (1) the State law must require that notice of local suits in State courts (as distinguished from Federal courts) be registered [etc.]; and (2) the State law must also expressly authorize notice of Federal suits to be registered, indexed, etc., in the same manner as notices in State courts. These provisions . . . will not become effective within a State until it has expressly authorized such registering, . . . etc. . . . .

"In order that Federal litigants may obtain the same protection as is offered in State court actions, the bill provides that the State law authorizing the registering, etc., of Federal notices must be the same as that for registering of State notices in State court actions . . . ."

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o advised that committee that H. R. 7306 did not apply

ess (1) the State already had a lis pendens statute and

the laws of that State also provided for similar record-

of notice of an action concerning real property pending

Defendant urges that this court has no power to cel the lis pendens or the registry of the same with Land Court.

As was said in Dice v. Bender, 117 A2d 725, Pa. 94 (1955):

> "The contention was there, as here, that the lien upon the properties obtained by the lis pendens could not be set aside by the court. This contention indicates a misapprehension of the doctrine in question . . . . [T]he effect of a lis pendens is not to establish actual liens upon the properties affected nor has it any application as between the parties to the action themselves; all that it does is to give notice to third persons that any interest they may acquire in the properties pending the litigation will be subject to the result of the action . . . . [L]ong before the enactment of any statutory regulations on the subject, the mere pendency of a suit in equity affecting the title to real property was held, both at common law and in equity, to constitute constructive notice thereof to all the world, and the registry statutes, so far from creating the doctrine, actually limited its application by making it effective only if the action were indexed in accordance with the statutory requirements. In short, being a creature not of statute but of common law and equity jurisprudence, the doctrine of lis pendens is wholly subject to equitable principles. Thus, . . . if the operation of the doctrine should prove to be harsh or arbitrary in particular instances, equity can and should refuse to give it effect, and, under its power to remove a cloud on title, can and should cancel a notice of lis pendens which might otherwise exist.
>
> * * * *
>
> "The court below undoubtedly had the inherent power to remove what was an unwarranted cloud on defendants' title . . . ."

From King v. Davis (cited by the defendant), supra 227-8, it is manifest that when a party has lost a t by fraud, accident or mistake -- particularly as here

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

LAHAINA-MAUI CORPORATION,
lifornia corporation,

Appellant,

v.

PH TAU TET HEW and HELEN
NA HEW, husband and wife,
GE TAN and SHIZUKO RUTH
husband and wife,

Appellees.

No. 20419

FEB 1 0 1967

APPELLANT'S REPLY BRIEF

FILED

JAN 3 1966

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UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

E LAHAINA-MAUI CORPORATION,
California corporation,

Appellant,

v.

SEPH TAU TET HEW and HELEN
ONA HEW, husband and wife,
ORGE TAN and SHIZUKO RUTH
, husband and wife,

Appellees.

No. 20419

APPELLANT'S REPLY BRIEF

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UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

E LAHAINA-MAUI CORPORATION,
California corporation,

Appellant,

v. No. 20419

SEPH TAU TET HEW and HELEN
IONA HEW, husband and wife,
ORGE TAN and SHIZUKO RUTH
N, husband and wife,

Appellees.

/

APPELLANT'S REPLY BRIEF

STATEMENT OF [illegible]

Appellees entered into an option to lease land to ppellants; upon exercise of that option, appellees refused to rform and brought this action to cancel the option. The urt below granted a summary judgment to appellees.

The sole question before this court is whether that mmary judgment can stand. The court must therefore determine, ong other things, whether there was any genuine issue of

terial fact between the parties, and in making such a determination
ie "Statement of Facts" given by the parties is of singular
portance. Appellees' "Facts" contain references to self-serving
tatements made by the Appellees which are nowhere acceded in
Appellant.[1/] Some of their "facts" are immaterial to a decision
a summary judgment[2/] and serve only to confuse the facts which
e open to consideration. Two statements, one of which is not
fact at all and the other an incorrect statement of the lower
urt's holding, deserve specific mention since they might otherwise
misleading to this court:

> Appellees make the statement at page 3 of their brief: "A proper subordination provision in the lease was basic and essential to enable the Appellant to obtain for the benefit of both lessor and lessee the proper financing for a proposed 2-3 story, 200 unit 'combination apartment hotel' project costing between

---

"Appellees, not experienced in the leasing of real property
:92)" (Appellees' Brief 2-3); "Appellees understood that this
ant prevented, during the term of the 'exclusive option,' the
pellees from negotiating a lease with any other person (R:84)"
ppellee's Brief 2-3)

See footnote 1 above. Additional examples: "were not represented
counsel (R:80)" (Appellee's Brief 3); second full paragraph,
ge 4.

$1,000,000.00 and $1,500,000.00." At no point in any of the references given by Appellees is there any indication whatever that the subordination was to be for the "benefit of both lessor and lessee"; nor is there any portion of the record that would permit the inference that this statement is fact at all. It is rather the assertion by Appellees of a legal conclusion on which the outcome of this case in large measure depends.

Appellees state at pages 2 and 6 of their brief that the court below ruled "that no contract to lease had been entered into because of the uncertainty and indefiniteness of its essential and material terms." The lower court made no such ruling; it found "indefiniteness" in the subordination provision of the option (R:105,115), but it at no time found that this meant there was "no contract to lease." This conclusion is one which Appellees urged on the court below - without success - and urge upon this court. It is a position they take, but it is not a fact. It should also be noted that Appellees use the plural "terms" in describing the indefiniteness found by the court below; the court was quite specific in finding indefiniteness in only one term - the subordination clause. (R:105,115).

Appellees make a further reference to what the court below did at page 10 of their brief; they say the court below concluded that as a matter of law the alleged option was insufficient under the Statute of Frauds." If they mean that the court specifically came to such a conclusion, their statement is simply untrue. If they mean that such a conclusion must necessarily follow from the court's decision, the statement is merely misleading in that it indicates the court below supported the argument they are introducing. The court below did not mention the Statute of Frauds in its holding.

ARGUMENT

Appellees' arguments tend at times to go in many rections and to be not clearly related to the issues in this se. To avoid confusion Appellant will reply to these arguments thin the framework of the issues presented. These are not mplicated. The case concerns an option to lease land belonging Appellees which Appellant has exercised. Appellees have fused to perform and have been awarded a summary judgment in eir action to declare the option void. The award of this mmary judgment is being appealed here by Appellant.

The District Court ruled that the option was, in all spects save only one, specifically enforceable under Hawaii w by virtue of the case of Francone v. McClay, 41 Haw. 72 (1955), case granting specific enforcement of an option to lease almost entical to the one here. There is, however, one clause in our tion which did not appear in that case, it being the underlined rtion of the following paragraph:

> Said lease shall contain the standard provisions normally contained in a lease for similar property situate in the State of Hawaii <u>together with the provision that the lessors shall subordinate their</u>

fee to permit the lessee to obtain financing

which provision is by way of example, but not by way of limitation.

his is the only respect in which the case at hand differs from rancone, but the court below ruled that the subordination rovision was too indefinite for specific enforcement as a matter f law and that therefor Appellant was not entitled to specific nforcement of any part of its contract nor to damages for its reach. Further, the court ruled that as a matter of law Appellant ould not waive the benefit to which it was entitled under the ubordination clause, and thereby obtain enforcement of the emainder of the contract. The entire case before this court thus nvolves the one provision underlined above and nothing more. here are three issues:

1) Is the underlined provision "indefinite" such that it cannot be specifically enforceable?[3/]

/ Appellees at page 16 state their position as being "that on he motion for summary judgment the court below had only to consider f there was a genuine issue of material fact on whether the sub-rdination clause tendered by Appellant (or any subordination clause) as or could be a standard provision 'normally contained in a lease or similar property situate in the State of Hawaii.'" This, of ourse, is clearly wrong; the question is whether the subordination lause in the option was sufficiently definite for specific enforce-ent. It can be definite in itself (which has always been ppellant's contention), or if not definite in itself, it can evertheless attain sufficient definiteness by reference to some xternal standard such as "standard provisions" (which has never been ppellant's position). See Restatement Contracts §370, Comment C. erhaps Appellees' misunderstanding of the issues explains the eeming lack of organization in their brief.

2) Even if the provision should be found to be not specifically enforceable because "indefinite," can it not be waived by the Appellant, thereby leaving the balance of the option specifically enforceable under the rule of Francone v. McClay?

3) Even if the option is incapable of specific performance under any circumstance, is not Appellant still entitled to an award of damages because of Appellees' refusal to perform?

I. As to the first issue (i.e., Is the provision which stinguishes this option from the one in the Francone case too lefinite for specific performance), Appellant showed in detail l at length at pages 11 through 17 of its brief that the provision ling for subordination is perfectly clear, perfectly simple and no wise indefinite. Appellant further showed that a ruling at such clause was indefinite would constitute a judicial inter- ence with freedom to contract which was contrary to all existing thorities and accepted jurisprudence of the common law. Appellees et this argument with many argument headings and many pages of rds and, when the smoke clears, only two arguments. These are:

(a) The underlined language, say the Appellees, means "that a provision subordinating the fee would be included in the lease along with other nonstandard provisions not mentioned and yet to be negotiated."

(Appellees' Brief 9).

(b) The subordination language is indefinite and unenforceable because "necessary elements of a subordination clause are omitted, such as the maximum amount of the construction loan, the terms of the loan including when the loan would become due, the rate of interest it would bear and the manner in which the loan would be paid." (Appellees' Brief 9)

These will be discussed seriatim:

(A) Appellees' argument that other nonstandard provisions re intended to be included in the lease is to Appellant's knowledge and new in this case. It was not mentioned insofar as can be called in oral argument nor raised in any of the memoranda led below. Certainly the interpretation was never adopted, even liquely, by the court below and Appellees apparently wish this urt to affirm the grant of summary judgment below based upon this v and independent ground. Appellees state that this interpretation the "obvious meaning" of the provision in question,[4/] but they e surely not serious. The asked-for interpretation is anything t obvious; it is strained and unreal. Further, this "interpretation" ies in the face of the use of "together with" in the provision:

4/ They do not explain why, if it is obvious, no one thought out it before.

> Said lease shall contain the standard provisions normally contained in a lease for similar property situate in the State of Hawaii <u>together with</u> the provision that the Lessor shall subordinate their fee to permit the Lessee to obtain financing which provision is by way of example, but not by way of limitation. (R:9)

last clause - "which provision is by way of example, but not way of limitation" - clearly refers to the "provision" which ecedes it. And that provision is definitely stated to be the exception to the proviso that the lease shall contain "standard visions." Nowhere is there any use of the plural or indication t more than the one specified "non-standard" provision was ended. Surely Appellee's "interpretation" would never be adopted any court merely from a reading of the words; rather its eptance would require a rather strong showing by parole evidence t this was the intention <u>despite</u> the words. But in order to vail on a motion for summary judgment as here, it must be found this court that the meaning of the words is so clear that parole dence <u>would not be admitted</u> to explain it. Such a finding h respect to this "interpretation" is simply not reasonable.[5/]

Even if the interpretation asked for by Appellant is valid, rely the provision does no more than give the parties permission arrange other nonstandard provisions later if they wished to. such case it is merely redundant, for the parties may always end or add to their contract later by mutual agreement.

(B) Appellees present a number of argument headings on
ie question of specific enforceability of the provision, but they
.l contain the same argument. One of these headings states that
ie option was insufficient under the Statute of Frauds because
'he subordination language was vague and indefinite." (Appellee's
'ief 10). Another is that "an option to lease which is incomplete
d uncertain cannot be specifically performed." (Appellees' Brief 13)
pellees do not indicate anything that is "incomplete and uncertain"
out this option other than the alleged indefinitness of the
bordination provision. Again: "as a matter of law, a subordination
ovision requires agreement on the conditions of the subordination."
ppellees' Brief 17) These conditions, it turns out, are the
ecessary elements" which were not included in this case and
ereby render the subordination clause indefinite (Appellees'
'ief 9,18). In short, all these headings introduce precisely
ie same argument -- that the subordination language is uncertain.
this is the appropriate issue, then it ought to be discussed
such and not obscured behind a number of confusing disguises.

The provision "that the lessor shall subordinate their
e to permit the lessee to obtain financing" surely is not
definite on its face. It describes fully and completely what
ie lessor is required to do.[6/] Appellees argue, however, and the

[6/] As Appellant pointed out in its opening brief (page 13), it offered
o supply experts to establish that the provision had a definite and
scertainable meaning as it stood. Appellees recognized in their
rief that "this amounted to an offer of proof of facts which precludes
ie entry of summary judgment." (Appellees' Brief 18)

wer court apparently agreed, that any subordination clause in der to be effective as an agreement between two parties must ntain "necessary elements" including the maximum amount of the nstruction loan, the terms of the loan, including when the loan uld become due, the rate of interest it would bear, and the manner which the loan would be paid. But there is no explanation of why se elements must be present, and no hint as to why a party cannot, he wishes, simply agree to subordinate his fee to whatever tent may be necessary in order for the lessee to obtain financing. Appellant points out at pages 15 and 16 of its brief, there is difference except in degree between an agreement to subordinate mpletely as here, or subject to any combination of restrictions ecessary elements"), or not at all. It is truly an unusual rule law which (1) permits a party who agreed to fully subordinate his terest in a piece of property, simply because of that agreement, avoid not only his obligation to subordinate but also all other ligations he might have incurred at the same time,[7/] but (2) requires party who agreed to a less-than-full subordination to comply in ll with all his obligations. Appellant is unable to find one

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Even though he may have received full compensation and the other rty was always prepared to perform in full. In this case Appellant id Appellees the sum of $1,000 for the option which had a life of ly slightly in excess of three months (R:8-9); Appellant is also epared to show at trial that the rental agreed to by Appellant s in excess of the value the land should have brought under a gular lease when the option was entered into.

ngle logical justification for this rule suggested by Appellees. e justification given by Appellees is as follows: They say) Appellant's contention that the provision is clear and definite "absurd"; and (2) that Appellant can only be correct if the bordination provision was one of the "'standard' clauses ntracted for." (Appellees' Brief 18) The first statement is not pported by further discussion or elaboration. The second atement is simply nonsense. No contention has ever been made at the subordination provision is a "standard" clause; the con- ntion is simply that as it is written it is clear, definite and forceable.[8/] A search of Appellees' brief for any further asoning to support the conclusion it asks for or to answer pellant's argument will be in vain.

Appellees simply rest their case upon a series of lifornia cases, none of which was decided by that state's preme Court. These cases are laid out and discussed by Appellees pages 20 through 27 and do unquestionably assert that the -called "necessary elements" asked for by Appellees must be ated in full detail alongside any subordination provision in der to render that provision specifically enforceable in California. at is their reasoning? What logic have they found that neither pellees or Appellant in this case are able to find? The answer

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8/ See footnote 3, supra.

: none. These cases constitute authority for the instant case
hich is governed by Hawaii law) only insofar as they are persuasive;
ey are not only unpersuasive, they are wholly devoid of any
gical explanation for the rule they espouse. As Appellant pointed
t at page 16 of its brief, all of the cases cited by Appellees
rely follow without reasoning or explanation the equally unreasoned
iter dictum in Gould v. Callan, 127 Cal.App. 2d 1, 273 P.2d 93
954) which they incorrectly refer to as the "holding" of that
se. As Appellant has indicated (Appellant's Brief 16-17) the
cision in these cases constitutes a substantial and a unique
terference with the rights of parties to a contract to bargain and
ree to what they will. Such an action cannot be justified by
ference to principles of the common law since it is contrary to
em, and in fact the decisions are purely and simply policy
cisions to the effect that unrestricted agreements to subordinate
ll not be enforced. Only one possible explanation can be found.
California the legislature has decided that purchasers of land
ving purchase money mortgages as a part of the purchase price
y not be held personally liable for the payment of such
rtgages.[9/] In other words, a seller of land is prohibited by law
om bargaining for and obtaining the personal liability of his

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California Civil Procedure Code §580(b).

rchaser and can have no security for payment of the balance his purchase price other than the land. In Hawaii, as in most other ates,[10] a seller can bargain for, if he wishes, both the personal ability of the purchaser and the land as his security; he could, he were willing to rely on the personal liability, allow a mplete subordination of his interest in the land - or indeed mply take no mortgage on the land - and not be left without some surance of repayment.[11] In California, if the seller agrees to a mplete subordination, the law forces him into a position where has given up all security. Perhaps this unique situation stifies the extremely unusual position taken by the California wer appellate courts,[12] but it seems more likely that the Supreme urt of California will refuse to adopt the position when the portunity presents itself. The important point here, however,

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/ E.g., Wodehouse v. Hawaiian Trust Co., 32 Haw. 835 (1933).

/ Surely no one would ever assert that a seller of land would not bound by an agreement to sell land for cash plus a promissory note t no mortgage at all. An opposite result should not follow from situation in which the seller takes cash plus a note plus a rtgage, but agrees to subordinate his mortgage. The latter sition is not legally different from the former.

/ One case outside California has been decided to this same fect in a trial court in New York State. Krusky v. Berger, 225 Y.S. 2d 797 (S.Ct. 1962), aff'd without opinion, 249 N.Y.S. 2d 8 (App.Div. 1964). It offered no reasoning or analysis, wever, and merely adopted blindly the holding of these California ses.

; that these cases are wholly unsupportable unless on the ground
iat they produce a special rule to meet a special situation. This
)ecial situation does not exist in Hawaii where personal liability
ı purchase money mortgages is the rule, and the cases offer no
:her persuasive justification for their use as authority to determine
awaii law. In short, Appellees' brief merely reiterates these
ases and repeats their holding. It does not, and the cases
) not, meet the arguments made by Appellant at pages 11 through
' in its brief.

II. The second issue is whether the subordination pro-
ision cannot be waived by Appelant, even though it itself may not
: specifically enforceable, thereby leaving the balance of the
)tion specifically enforceable under the rule of Francone v. McClay.
)pellant, in its brief (pp. 18-32) cited and quoted from numerous
uthorities in a large variety of jurisdictions establishing the
ıle that a provision in a contract may be waived by the party
ıtitled to the benefit thereof thereby entitling him to specific
ıforcement of the balance of the contract. Many of these cases
re elaborately and carefully reasoned; all of them involve a
)ntractual provision which could not be specifically enforced
)r one reason or another and the courts granted specific performance
: the balance of the contract. Every one of these cases constitutes

distinguishable authority for Appellant's contention that waiver of e subordination clause in this case was perfectly proper and that ecific performance of the balance of the contract should have been anted. Appellees' brief does contain a discussion of these cases, ough its thrust is not always clear. For example, a name is at- ched to a group of Appellant's cases, ("Waiver of Performance ses"), and then they are distinguished from our case on the follow- g ground: the contracts involved in these cases are "valid, binding d certain in all their terms, the only problem being whether the rms are specifically enforceable or whether equity is the proper medy." (Appellee's Brief 34). It is by no means clear why this con- itutes a distinction and Appellees do not elucidate.[13/] These ses segregated by Appellees simply involve a provision which is t specifically enforceable for a reason other than that it is definite. But this is a distinction without a difference for ere is no material difference between provisions which are not ecifically enforceable because they are indefinite and provis- ns which are not enforceable for any other reason. The import- t factor is that in each case there was a provision which

13/ Probably Appellees do no more here than reiterate the same gument they make over and over - that our case is different cause, somehow, we have no contract.

ıld not be spe ically enforced and in each case the
ıtract was sp ically enforced without that provision. This
precisely w the court should have done in this case. It
perhaps appropriate to note that Appellees' "distinction" has not
n adopted by any of the other courts which have considered
matter; there are a large number of cases cited by Appellant
which a provision was not specifically enforceable because
lefinite yet the balance of the contract was specifically enforced.

Appellees then form another group of the cases cited
Appellant and attach a name to them (The Deferred Payment
es"). They state that "in all the deferred payment cases the
.ver was either made within the time period allowed in the
ıtract or the contract was silent as to time." (Appellees'
.ef 34) It is by no means clear what this statement means or
it was inserted. It cannot mean that there was a "time period
.owed" for waiver in any of these cases, for there was no
h thing. Appellant cannot find any content in the words "contract
silent as to time" in this context. One might guess, from
ıding that portion of Appellees' brief following the statement
ıt what was really meant was that in the cases cited the waiver
taken place before the time for exercise of the option or
eptance of the contract or that there was no such time specified.

rtainly Appellees appear to give this impression when they point that waiver was only offered in this case when it got to trial d "no case has been cited or discovered when a court has allowed waiver of an essential term at such a time." (Appellees' Brief 35) t Appellees could not really have meant that either, for it is t true. In Trotter v. Lewis, 185 Md. 528, 45 A. 2d 329 (1946), option case, the offer to waive the unenforceable term was made in en court. In Levine v. LaFayette Building Corp., 103 N.J. Eq. 121, 2 Atl. 441 (1928), the offer to waive was apparently made in the eadings. In Haire v. Patterson, 63 Wash. 2d 282, 386 P.2d 953 963), the waiver was not made until the termination of the case en the court granted specific enforcement conditioned upon the aintiff waiving his benefits under the indefinite provision. bbell v. Ward, 40 Wash. 2d 779. 246 P.2d 468 (1952), is the same this respect as Haire. Appellees also say, with respect to the eferred payment cases" that "with one possible exception, the ovisions of the contracts involved in the deferred payment cases rmitted, either expressly or by implication, the cash payment of the lance of the purchase price and the courts were not in the position having to change the terms of the agreement involved." (Appellees' ief 38) This statement simply does not give an accurate

scription of the cases. Three of them - one-half of the total der discussion - contain no prepayment provision.[14] These three ses were credit sales and the courts did change the terms in der to grant specific performance.[15] Further, Appellees on the ne page state (at footnote 1) with respect to the exception they cognized, "The New Jersey rule is clear, however, that a belated iver in open court as attempted in the instant case would not be lerated. 142 Atl. at 449." The cited page says nothing of the rt.

Appellees state at page 33 of their brief that if this se involved a subordination clause "with the terms... definitely set rth," and if Appellees were unable to perform, then Appellant uld waive the subordination provision and obtain specific perform- ce. There is no difference between this supposed case and the medy sought by Appellant here in terms of outcome, in terms of irness or justice to the Appellees, in terms of justice to Appelant,

/ Blanton v. Williams, 209 Ga. 16, 70 S.E.2d 461 (1952); Levine v. LaFayette Building Corp., 103 N.J. Eq. 121, 142 Atl. 441 (1928); Trotter v. Lewis, 185 Md. 528, 45 A.2d 329 (1946)

/ The authorities have long recognized that such cases as these d the "waiver of performance" cases do involve the specific per- rmance of a contract different from that agreed upon by the parties. statement Contracts §359(2); Note, Specific Performance with Abate- nt of Purchase Price, 25 Harv. L. Rev. 731 (1912).

in any other terms. The only difference is that in one case the ellees cannot perform and in the other they will not; there is reason in law or logic why this should alter the outcome so far as ellant is concerned. It is submitted that there is no legally nizable difference between the two cases and that Appellees' ission is an admission that Appellant is entitled to prevail here.

Appellees cite two cases of their own with respect to the piety of waiver. One of them, Roven v. Miller, 168 Cal. Ap. 2d , 335 P.2d 391, 335 P.2d 1035 (1959), simply involved an option ch expired before it was exercised. This case has no relevance tever to the question before the court and there is no apparent son for its having been cited. Neither of the parties to this e has been able to find a case from a federal court or from the hest court of any state involving an attempted waiver of a ordination clause. Only one case could be located, and it was m the California District Court of Appeals. In this case, Magna elopment Company v. Reed, 228 Cal. App.2d 230, 39 Cal. Rptr. 284 64), the court refused to accept the waiver on the ground that do so "would be allowing the unilateral creation of a new, ferent contract."[16/] The court had previously held that the sub- ination provision was indefinite. This previous holding was not soned or elaborated but rather was based upon blind adherence

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See note 15, supra.

the pre-existing California District Court of Appeals cases ready discussed. The court's holding that waiver could not be rmitted was equally unreasoned. The court made no effort to explain y permitting such a waiver would make a "new, different contract". ither was there citation of any of the other waiver cases or dis- ssion of the reason why the case before the court should be cided differently from them. It is the only case found by pellees to support them in resisting waiver of the subordination ovision in this case and it is directly contrary to the very sub- antial body of cases from the highest Appellate Courts of numerous risdictions cited by Appellant (Appellant's Brief 18-32). There is way that this case can be squared with them; either it is wrong, all the others are wrong. Appellant submits that the others ate a true and established rule of equity jurisprudence which has thstood the test of time, that they are inherently more logical, d that they are reasoned and reflective of the basic aims of the mmon law including that of effectuation of contracts wherever ssible.

Appellees also make an argument which seems to say that nce there were no restrictions placed upon the agreement to bordinate, the Appellant has never been bound to accept a lease hich did contain such restrictions and thus there is no mutuality remedy. The result of this apparently is that the Appellant's

ercise of the option to lease did not become a bilateral contract. ppellee's Brief 35, 36). The meaning is not altogether clear, but rhaps this is simply another reiteration of Appellees' argument the effect that our case is different from the others because have no contract. The argument simply assumes its own validity prove the validity of its conclusion - i.e., specific performance nnot be granted because there is no contract, and the proof that ere is no contract is that specific performance will not be anted. It is purely circular.

Finally, Appellees at page 36 of their Brief reach the issue raised by the lower court's decision: Is this case fferent from all the other waiver cases because they involved visions solely for the benefit of one party (who was waiving) our case involves a provision for the benefit of both parties. re is, as Appellant pointed out in its opening brief (p. 29) no h thing as a clause in a contract which can never be to the efit of both parties. The question that must be faced if this e is to be distinguished from all the others is whether the ordination clause is beneficial to the subordinator in any stantially greater or different degree than the provisions in other cases are beneficial to the party resisting specific orcement.[17/] The answer to this must be in the negative - in t, as Appellant has pointed out (Opening Brief 29), the con- se is true.

It is appropriate to note that all of the evidence ilable to the court below in making its decision showed that subordination clause was asked for and insisted upon only by ellant. For example, in the deposition of Mr. Ching, who

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[17/] Of course, many of these cases involve, like this one, a sit- ion whereby one party is trying to avoid a contract by refusing perform a part of it and utilizing that as a basis for being ex- ed from the rest. The courts and writers have recognized this one of the factors mitigating against allowing such a party to ceed. See, e.g., Morris v. Ballard 16 F.2d 175, 176 (D.C.Cir. 6), Wesley N. Taylor Co. v. Russell, 194 Cal. App. 2d 816, 15 .. Rptr. 357, 365; Fry on Specific Performance of Contracts, . 830 (3d ed. 1884).

Appellees state, was acting as Appellant's attorney, he stated
er questioning by Appellees' attorney that the subordination
use was requested by Appellant and Appellant alone, and that
eed Appellant insisted the provision would be necessary if it
e to obtain financing (Ching Deposition 27-28). Mr. Ching was
o asked whether restrictions on the degree of subordination had
n agreed to. Mr. Ching answered in the negative, stating that
agreement was "that this would be a full, you know, complete
ordination of their fee interest, period." (Ching Deposition
. Even the explanation made by Mr. Ching to the Appellees of
t a subordination clause was all about during the negotiations
candidly and forthrightly to the effect that such a clause was
to the benefit of lessors and all to the potential detriment
the lessees. (Ching Deposition 32; See also Low Deposition 10,
12). There is no indication anywhere in the depositions or
er material before the court below (other than the self-serving
tements of Appellees on their interrogatory answers) that there
any intention that the subordination provisions should benefit
Appellees or that they expected or bargained for any benefit
refrom.

How then do Appellees answer Appellant's analysis of
nature and effect of a subordination provision and conclusion
t it could not be mutually beneficial? They cite no authority;
y give no analysis and indeed, even fail to take issue with

rmitted involved a far more plausible and realistic "benefit"
the resisting party than anything the Appellees could assert
re. Indeed, Appellees do little more than assert that "it is
vious that the Appellees contemplated that they would receive
benefit by having a completed structure on their premises...."
ppellees' Brief 37). There is not even a hint why this should
'bbvious" even though all available evidence is to the contrary.
ther is there any explanation of why, if Appellees were primari-
interested in the type of building to be constructed, that
tter was not covered in the option. Further, both Mr. Ching
l Mr. Low state in their depositions that although buildings
re mentioned by the parties in their negotiations, the Appellees
ught to impose no restrictions or minimum requirement upon the
ssees. Rather, Mr. Ching reported that "from the discussions,
e lessee would have complete control of it". (Ching deposition
; See Low deposition 15).

Appellees suggest that Appellant offered in its brief
n effect, to negotiate the terms of the subordination provision
th the Appellees...." (Appellees' Brief 38). Appellant never
ffered to "negotiate" in its brief;[18/] its position was made

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18/ Appellant's statement was: "If Appellees wish, the Appellant
ll be happy to alter its offer to waive the subordination pro-
sion by offering to waive only so much thereof as Appellees de-
re; the Appellees may then subordinate their fee simple interest
much as they wish." (Opening Brief 31).

rfectly clear and has not been refuted. Appellees have refused perform their obligations under a contract, the terms of which re bargained for, and substantial consideration for which was id. (R. 8-9). They then utilized their own unwillingness as a sis for asking this court to excuse them from performance of l their other obligations under that contract, notwithstanding pellant's willingness to perform fully and completely all its ligations thereunder. Appellees in one breath refuse to execute subordination agreement and in the next refuse to execute a ase without a subordination agreement because subordination is neficial to them. If it is true that some benefit accrues to pellees from a subordination provision, then Appellant is lling to accept a degree of specific enforcement of the option anting Appellant a lease containing a subordination provision ich contains only such subordination provisions as are beneficial Appellees - in short, Appellant will waive all benefit it is receive under the said clause but will permit Appellees to tain all benefit which they alleged they will receive thereunder. rely the offer of waiver in this form eliminates any distinction at might be drawn between this case and the myriad others in-lving waiver on the ground this case involves a provision with nefits accruing to both sides; further, it properly places upon pellees the burden of showing what this "benefit" is that they

not wish to give up.[19]

III. The third issue is whether Appellant, if not entitled specific performance, is not then entitled to damages arising of Appellees' refusal to perform. Appellant believes Appellees' ef fails to meet the discussion and authorities given in its ning brief and will therefor make no further reply here.

IV. There is a final issue presented in this case: Did lower court err in cancelling Appellant's Motion of Lis Pendens?

The lower court apparently shares a not uncommon confusion to the distinction between lis pendens and a notice of lis pendens. former is a doctrine which provides that a purchaser who ac- res an interest in property that is involved in pending litiga- n stands in the same position as his vendor.[20] The underlying ory of this ancient doctrine is that once a controversy has n subjected to the jurisdiction of the courts it should be im- sible for any of the parties to interfere with consummation of courts' judgment. The doctrine itself has not been altered

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There is and can be no real question that the subordination use was intended to and does in fact benefit only the Appellant. must be borne in mind that the question is whether the Appellees ld be better off with no subordination than with some - and the den is upon them to show that some degree of subordination of ir fee simple interest is more beneficial to them than no sub- ination whatever. The mere fact that there is a risk they will e their interest in the former case and no such risk in the ter case precludes any such showing.

34 Am. Jur. Lis Pendens Sec. 2.

statute in Hawaii.

At common law all purchasers of property were deemed have constructive notice of litigation affecting title to such perty. Hawaii has altered this common law rule for actions the state courts by requiring that a notice of such litiga- n (i.e., Notice of Lis Pendens) be filed in the Bureau of veyances and/or with the Assistant Registrar of the Land rt.[21]

If Appellees are correct in their conclusion that the aii statute[22] does not "require" the recording of a notice of Pendens for actions pending in Federal Courts, and that there- 28 USC Sec. 1964 does not apply to this action, they have ely established that the doctrine of lis pendens will apply any purchaser of the land even though no notice of lis pendens filed.[23] If this is the case, then the existence of Appellant's ice of Lis Pendens was an irrelevance; it created no obstacle anyone and provided in itself no cloud upon Appellees' d. In this circumstance there was no one whose interest had may have become affected by the existence of the notice,

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RLH Secs. 230-42, 342-78.

RLH Secs. 230-42; no mention seems to be made of the compar- e statutory provision for land under the jurisdiction of the d Court, RLH Secs. 342-78.

King v. Davis, 137 Fed. 222 (Va. Cir. 1905).

luding the Appellees, and thus no "actual and antagonistic
ertion of right".[24/] In short, the district court had no juris-
tion to cancel the lis pendens since it could not do so within
framework of a "case or controversy".

If, on the other hand, Appellees' conclusion is incor-
t and if a notice of lis pendens is required in Hawaii for
ions in Federal as well as State courts, then the reasoning
authorities given in Appellant's opening brief stand unanswered
Appellees and establish that the cancellation was in error.

I certify that, in connection with the preparation of
s brief, I have examined Rules 18 and 19 of the United States
rt of Appeals for the Ninth Circuit, and that, in my opinion,
foregoing brief is in full compliance with those rules.

Richard P. Schulze, Jr.
Attorney for the Appellant

[24/] U. S. v. Johnson, 319 US 307, 87 L.Ed.1413 (1943).

UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

E LAHAINA-MAUI CORPORATION,
California corporation,

Appellant,

v. No. 20419

SEPH TAU TET HEW and HELEN
ONA HEW, husband and wife,
ORGE TAN and SHIZUKO RUTH
N, husband and wife,

Appellees.

CERTIFICATE OF SERVICE

I hereby certify that on the 29th day of December, 1965, caused to be mailed (First Class Mail) in the U. S. Post fice at Honolulu, Hawaii, postage thereon fully prepaid, three pies of the foregoing brief of the above named Appellant, THE AINA-MAUI CORPORATION, addressed to Mr. William M. Swope, Smith, d, Beebe & Cades, First National Bank Building, Honolulu, Hawaii.

DATED at Honolulu, Hawaii, this 29th day of December, 65.

RICHARD P. SCHULZE, JR.

No. 20426

In the

United States Court of Appeals

For the Ninth Circuit

THOMAS T. COHEN,	*Appellant,*
vs.	
UNITED STATES OF AMERICA,	*Appellee.*

On Appeal from the United States District Court for the District of Arizona

Brief for Appellants

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No. 20426

In the

United States Court of Appeals

For the Ninth Circuit

THOMAS T. COHEN,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

On Appeal from the United States District Court for the District of Arizona

Brief for Appellants

JURISDICTIONAL STATEMENT

The appellant, Thomas T. Cohen, was found guilty on March 17, 1965 by a jury, of ten counts of mail fraud, Sec. 1341, Title 18 U.S.C., and one count of using a fictitious name in support of the scheme to defraud, Sec. 1342, Title 18, U.S.C. Timely motions for a judgment of acquittal and for a new trial were filed. Same were denied on May 17, 1965, at which time the Court sentenced the appellant to two years each on Counts 1, 2, 3, 4, 5, 6, 7, 9, 10, 11 and 12 (count 8 having been dismissed), the sentences to run concurrently. The Court also ordered the defendant to be eligible for parole pursuant to Title 18, U.S. Code, Section 4208A (2).

The matter is before this Court pursuant to Title 28, U.S. Code, Section 1291.

STATEMENT OF THE CASE

The indictment No. 16986 in the present case was returned on September 9, 1964, and the arraignment was in Phoenix on October 6, 1965. *(TR 1A, P. 197), charging the defendant with eleven counts of mail fraud, and one count of using a false and fictitious name.

This indictment is the same as was returned in Cause No. 16545 (TR Vol. 1, P's. 1-5). The indictment in Cause No. 16545 was filed on February 27, 1963 (TR Vol. 1, P. 74) and the Bench warrant of arrest was issue on the same day. (TR Vol. 1, P. 74). The Warrant was received by the United States Marshal for the Southern District of Florida on March 4, 1963 and executed by that Marshal on November 8, 1964 (TR Vol. 1, P. 74). When the indictment in No. 16545 was filed and at the time the Warrant was received by the U. S. Marshal for the Southern District of Florida, the defendant was already in custody in that same district awaiting trial on other Federal charges, pending in that district (TR 1, P's. 30-31) (T of T† July 27, 1965, P. 22, P. 26). Thus the defendant was in federal custody at the time the Marshal received the Warrant in the very same district where the Warrant was received. Yet, he was not arrested, arraigned, served, or otherwise notified of the charges against him from March 4, 1963 until November 8, 1963, which by *coincidence?* is the day the last of the three

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*TR refers to Transcript of Record.

†T of T of July 27, 28, refers to the Transcript of testimony and argument before Judge Mathes on the motion to dismiss for lack of speedy trial.

indictments in that district was dismissed by the Court. (T of T July 28, 1964, P's. 33 through 35).

The defendant was arraigned on December 30, 1963 and entered a plea of not guilty to all counts (TR Vol. 1, P. 74). On January 25, 1964, a timely motion to dismiss the indictment for lack of speedy trial was made on behalf of the defendant (TR Vol. 1, P. 74). A hearing was held pursuant to this motion on July 27, 1964. (TR Vol. 1, P. 74, 75).

The Court found that the action of the government offended every sense of the right to a speedy trial under the Sixth Amendment (T of T July 28, 1964, P. 37) and the Court, after having heard of the defendant's detention by federal authorities for 18 months without ever standing trial (T of T July 27, 1964, P. 24) and the other circumstances of the defendant's plight stated "It savors of Russia to me" (T of T July 28, 1964) dismissed the indictment (T of R, Vol. 1, P. 72 and 73).

Shortly thereafter, in September of 1964, the Grand Jury for the District of Arizona returned the exact same indictment, which was now numbered 16986 (TR 1, P's. 77-91). A timely motion to dismiss with prejudice was filed on the grounds that the dismissal of the indictment in No. 16545 was a bar to the prosecution of this indictment (TR 1-92). The government filed a memorandum in opposition thereto (TR 1-100) and on December 14, 1964 the Court entered an order denying the motion to dismiss with prejudice (TR 1-103) apparently because the defendant failed to show how he was prejudiced (TR 1-104) and because Judge Craig interpreted Judge Mathes order to be based on the Government's failure to prosecute (TR 1-104) rather than on a violation of a right to a speedy trial pursuant to the Sixth Amendment.

The cause proceeded to trial on March 9, 1965.

The indictment is quite lengthy (TR 1-77-91) and charges essentially the defendant with a scheme to defraud by use of the mails (TR 1-77); that certain corporations would be formed (TR 1-79); that the defendant would use the name Al Sherman (TR 1-79) and certain land would be subdivided and purchased (TR 1-80). Although other matters are charged the gist of the indictment is that certain fraudulent representations would be made to induce people to accept the lots (TR 1-83).

The alleged misrepresentations concerned the nature, condition, geography, topography and availability of the land (TR 1-83-84).

The government had well over 25 witnesses testify that the representations were made as alleged in the indictment by certain persons other than the defendant who were associated with the corporations named in the indictment. Some of these were Crawford * (P. 654), Bird (662), Younger (582), Papadapolous (544), Nelson (530), Sievertson (368), Marsh (376), Abrams (382). The government introduced several witnesses to show that the representations were not true (758-62, 762-767, 768 through 776). Perhaps the strongest government witness to show that the representations made to the people who were acquiring the land were false was the government witness Kimber (766-785 and 787-808) who testified the land unavailable, uninhabited, and impassable.

The government attempted to tie these various representations to the defendant by only a few witnesses. The first was Pinkerton who testified he worked for the defendant (191) and the defendant told him what to tell the customers (231-234). Pinkerton's testimony was severely im-

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*Numbers standing alone refer to page numbers in the transcript of the testimony at the trial.

peached (258-267; 271-276). The witnesses Opalek (314-321) Brandon (498-499) and Boyer (605-621) testified in substance that the defendant was present when some of the representations were made. The witness Saunders gave some corroboration to Pinkerton's testimony which was also impeached (519, 355-368). There was no testimony that the defendant knew the representations were false.

On the contrary, if he did make any representations, he was only repeating what he had been told about the land by Hermanson who sold it to him (858-890, and more particularly 872, 873, 890, 891).

The defendant did not take the stand.

There was not a Court Reporter in Chambers. The government first offered an instruction concerning the defendant being a competent witness, but since the defendant did not take the stand the instruction was withdrawn (TR A1 P. 171).

There was, however, a discussion in Chambers concerning an instruction to the jury covering the defendant's failure to take the stand (1283).

While Government Counsel was arguing defense Counsel passed a note to the Court (Court Ex No. 7) to be certain that the Court would give the proper instruction on the defendant's failure to take the stand.

The Court indicated to Defense Counsel that the Court would take care of it (1285, 1286). After the Court indicated to Counsel that the proper instruction would be given, the Court read the instructions to the Jury (1237-1274). At the conclusion of the reading of the instructions the Court again inquired if Counsel had any further instructions (1274).

Defense Counsel now for the second time in open Court reminded the Court about the instruction (1274). Govern-

ment Counsel also inquired about the instruction concerning the failure of the defendant to take the stand. The record clearly shows the instruction was not given (1275, 1277, 1278).

Although the record may be somewhat confusing, the Court was well aware that Defense Counsel repeatedly requested the Court to give the proper instruction on the defendant's failure to take the stand (1278).

The Court was of the opinion it was covered, but it was not (1278). The Court merely stated that "The Law does not impose upon a defendant the duty of producing any evidence, including his own testimony" which was merely added to that part of the usual instruction on burden of proof (1261) (TR 1A 139). There was no instruction given or any form thereof that the Law does not compel the defendant to take the witness stand and testify, and no presumption of guilt may be raised and no inference of any kind may be drawn from the failure of the defendant to testify (1283) (Court Ex No. 7). The Court was of the opinion it was covered (1285-1286 and 1287).

SPECIFICATIONS OF ERROR

1. The Trial Court erred when it denied the motion to dismiss the indictment for the reasons that the prior dismissal based upon a violation of the speedy trial clause of the Sixth Amendment operated as a bar to the present prosecution.

2. The Trial Court erred when it failed and refused to instruct the jury that the law does not compel a defendant to take the witness stand and testify, and no presumption of guilt may be raised and no inference of any kind may be drawn by the failure of the defendant to testify.

ARGUMENT

I. The Court Erred in Not Dismissing the Indictment With Prejudice Because the Dismissal of the First Indictment Barred the Filing of the Second Indictment

The order of July 28, 1964, found that the defendant was in the custody of the United States from June 13, 1962 until November 8, 1963 awaiting trial on indictments not connected with this case; which were pending in the Federal District Court for the Southern District of Florida.

The indictment in Cause No. 16545 was filed with the clerk of this Court on February 27, 1963. The appellant was arrested on this charge November 8, 1963 and the file warrant was returned executed on December 11, 1963. (TR 1-73) The defendant was not arraigned until the last week of December, 1963 (TR 1-104). The appellant is protected by his constitutional right to a speedy trial, even though the delay was caused by the imprisonment of the appellant for another offense, in the absence of the showing of reasonable effort by the Government to obtain defendant's return for trial, *Taylor v. United States*, 238 F.2d 259 (C.A.D.C. 1956.)

In the *Taylor* case the defendant had been serving a sentence in a penitentiary of New York until he was returned to the District of Columbia for trial. The Court said at page 201, *Taylor supra*

> "The Government urges that the delay in bringing appellant to trial was his fault, since it was caused by his imprisonment in New York. We think his imprisonment there does not excuse the Government's long delay in bringing him to trial here, in the absence of a showing that the Government, at a reasonably early date, sought and was unable to obtain his return for trial. It does not appear that the Government made any such effort before its' successful effort in 1956, though the crime was committed in 1950 and the indictment returned in 1954."

In the case at bar, the Government made no effort for eight months until all of the indictments were dismissed in Florida, then on the day the last indictment was dismissed they served the Warrant in the district where he had been held for at least eight months prior to the arrest of the defendant while the defendant was in custody of the Marshal. The Court in *Taylor* went on to say:

> "In this case, however, as stated, there is no showing that appellant even knew he was indicted and entitled to a trial."

The above quote is exactly applicable to the case at bar, because here some eight months after the Warrant had been forwarded to the Southern District of Florida where the defendant was being held on other charges until it was served in November, 1963; the appellant in this case had no idea that there were charges pending against him in another district even though he was in Federal custody at the time. It has long been the law that an accused cannot be denied speedy trial because he is serving sentence on another conviction. *Frankel v. Woodrough* 7 F.2d 796 (C.A.8 1925)

In the present case the defendant was not even serving a sentence for any crime for which he had been convicted, but rather was awaiting trial on other charges, all of which were ultimately dismissed (TR 1-72). In *Frankel supra* the Court said at page 798:

> "The question before us has been before several of the State Courts. The great weight of authority is that imprisonment under sentence does not suspend the right to speedy trial but that either the State or the convict can insist thereon . . . From the standpoint of the accused, the logic of this view is well expressed in *State vs. Keefe,* 17 Wyo. 227, 98 Pacific 122, . . .

> "The right of a speedy trial is granted by the Constitution to every accused. A convict does not accept it, he is not only amenable to the law but is under its protection as well. *No reason is perceived for depriving him of the right granted generally to accused persons, and thus in effect, inflict upon him an additional punishment for the offense of which he has been convicted.*" (Emphasis added.)

This language is equally applicable to the facts in the present case. Should the appellant here be penalized of his rights to a speedy trial merely because he was awaiting charges in another district? Our position is, certainly not!

In the case presently on appeal, there was not even a conviction, but rather eighteen months of imprisonment awaiting trial on three other charges which were dismissed (TR 1-72).

> "At the time of the defendants trial upon the one information he was under the protection of the guarantee of a speedy trial as to the other. It cannot be reasonably maintained we think, that the guarantee became lost to him upon his conviction and sentence or his removal to the penitentiary, *Frankel supra* at 798."

It is the appellant's position in this case, that he maintained at all times his rights to a speedy trial and that they were not lost merely because he was awaiting trial in another district. The trial court found that the defendant was in the custody of the United States for a period of at least nine months while this indictment was pending and was denied an opportunity to prepare his case and have the right to a speedy trial, and the court further found that the defendant had been deprived of his right to a speedy trial pursuant to the Sixth Amendment of the Constitution of the United States (TR 1-73).

Rule 48(b) of the Federal Rules of Criminal Procedure merely butresses and codifies in the form of a rule the rights to a speedy trial pursuant to the Sixth Amendment.

> "In 1944, the Supreme Court adopted the Federal Rules of Criminal Procedure. Rule 48 deals with 'Dismissal'; subdivision (b) of that rule is as follows: '(b) By Court. If there is unnecessary delay in presenting the charge to a grand jury or in filing an information against a defendant who has been held to answer to the district court, or if there is unnecessary delay in bringing a defendant to trial, the court may dismiss the indictment, information or complaint'."
>
> "The note by the Advisory Committee on Rules to subdivision (b) was terse: This rule is a restatement of the inherent power of the court to dismiss a case for want of prosecution. Ex parte *Altman,* 34 F.Supp. 106, [D.C.] S.D. Cal."
>
> "Rule 48(b) has the same effect in implementing the Sixth Amendment as an Act of Congress would have had. Thus, rule 48 merely implements and gives guide lines to the Court for enforcing the Sixth Amendment, *Petition of Provoo* 17 F.R.D. 183, 199-200."

Rule 48(b) is merely a contemporary enunciation of the Constitutional right to a speedy trial guaranteed by the Sixth Amendment, *U.S. v. Palermo* 27 F.R.D. 393 at 394 (1961).

Thus the Court in dismissing the case upon the ground of unreasonable delay in bringing the defendant to trial after it had found that the defendant had been deprived of his right to a speedy trial pursuant to the Sixth Amendment of the Constitution of the United States, was merely implementing the Sixth Amendment by using Rule 48(b); thus pursuant to the finding of the denial of the right to a speedy trial under the Sixth Amendment, Rule 48(b) was used to dismiss the case (TR 1-73).

The order of December 14, 1964 (TR 1-103) denying the motion to dismiss the indictment with prejudice seems to be based on the distinction between the dismissal of a failure to prosecute rather than a dismissal based on the finding of a denial of a speedy trial pursuant to the Sixth Amendment.

At the outset it should be stated, that the order of July 28, 1964 was not that it was dismissed on the Government's failure to prosecute, but it was dismissed upon the grounds of unreasonable delay in bringing the defendant to trial *after* there had been a finding that the defendant had been deprived of his right to a speedy trial pursuant to the Sixth Amendment of the Constitution of the United States (TR 1-73). Thus it is the defendants position that the deprivation of the rights pursuant to the speedy trial is synonymous with the dismissal upon the ground of unreasonable delay in bringing the defendant to trial (TR 1-73).

State courts have a long history of holding that when the first indictment is dismissed for reasons making effective the Constitutional guarantee of a speedy trial, a detention or trial under a second indictment for the same offense is illegal, *People ex rel Nagel v. Heider et al*, 80 N.E. 291, 225 Ill. 347 (1907).

There the Court said:

> "When a person tried for a crime brings himself within the provisions of the Statute he is entitled to be set at liberty and cannot afterward be committed or held for the same offense when charged therewith by a second indictment. *Brooks vs. People* 88 Ill., 327. In that case, it was considered that any other construction would open the way for a complete evasion of the Statute, which of course, is plainly apparent. The provision of the Constitution can only be given its legitimate affect by holding that a person once discharged is entitled to immunity from further prosecution for the same offense, and that construction was again adopted in the

> case of *Newlin vs. People* 221 Ill., 166, 77 Northeast 529. It is true as said by the attorney general, that the affect of such a construction might be to bar a prosecution of one guilty of violation of the Criminal Law, but it does not follow that the Constitution and Statute should not be obeyed. It might with equal propriety be argued that the Statute of Limitations as to prosecutions for criminal offenses should not be enforced for the same reason. The detention of the relator under the second indictment for the same offense for which he had been committed and indicted was illegal."

An excellent history of the Constitutional right to a speedy trial is contained in *Petition of Provoo* 17 F.R.D. 183, at p. 196.

There the Court said:

> "The right to a speedy trial is of long standing and has been jealously guarded over the centuries."

We take the position to this Court that if it fails to enter a judgment of acquittal, it has in effect, nullified the Sixth Amendment as it applies to this defendant.

The issue can be quite simply stated—can the Government re-indict when the prior indictment has been dismissed after there has been a finding that the defendant's rights to a speedy trial have been abrogated and violated within the meaning of the Sixth Amendment to the Constitution of the United States?

This exact factual question has yet to be placed before a United States Circuit Court of Appeals, nor is there any authority truly on all fours with the fact situation here in any of the Federal District Courts. A general outline of the law in the question may be found at 50 A.L.R. 2d 943. That annotation contains essentially an analysis of the State Court rulings which go off in three areas.

Some states have specific statutes that permit the refiling of an indictment when a trial has not been held on the previous indictment within the prescribed time period.

Other states have statutes specifically stating that the accused shall be acquitted of the offense in the event he is not brought to trial within a prescribed time period. In the states which do not have statutes, the Courts have held both ways. 50 A.L.R. 2d, pages 962 and 963.

Although the facts as presented in this case were not before the Court, the question has been ruled upon quite recently in the case of *Mann v. U. S.*, 304 Fed. 2d 394 (C.A.D.C. 1962). In that case the indictment was dismissed for want of prosecution and the Court held that when a case is dismissed for want of prosecution, it may be re-filed. Counsel for the appellant maintained that the defendant had been denied the right to a speedy trial. The Court rejected this claim. The Court went on to say that in the event there had been a finding of the denial of a right to speedy trial, then the proper remedy is dismissal and this dismissal would be a bar to a subsequent prosecution. The Court said at page 397:

> "We also agree that a dismissal based on a finding that the constitutional right to a speedy trial has been denied bars all further prosecution of the accused for the same offense. While there appears to be no express articulation of the rule in the reported decisions, it is the unspoken premise of all the cases involving the speedy trial clause. (Footnote 6—indeed, if it were otherwise, it is hard to understand why the government would ever appeal from the dismissal of an indictment, rather than simply re-indict). *It is, moreover, a necessary rule if the constitutional guarantee is not to be washed away in the dirty water of the first prosecution, leaving the government free to begin anew with clean hands.*" (Emphasis Supplied.)

The *Mann* case, supra, appeared to be the only Federal case close to point, however, the *District of Columbia v. Healy,* (Municipal Court of Appeals for the District of Columbia, 1960) at 160 Atl. 2d 800, has ruled that in the absence of a statute, a dismissal amounts to a bar to a subsequent prosecution. There the Court commented:

> "If the Government may proceed with a second information, the delay is simply compounded."

There appears to be confusion among the states involving the right of a government to re-indict a defendant subsequent to the original indictment being denied on the ground that defendant was denied his constitutional right to speedy trial. This confusion may exist as a result of three widely held concepts: the Statute of Limitations, the right to a speedy trial as guaranteed by the Constitution, and the right not to be placed in jeopardy twice for the same offense. These concepts have a common thread running through them, namely, that the government has only one shot at a defendant and that the defendant should have the opportunity to prepare his case within a certain time period.

This, of course, places a requirement upon the prosecution, namely, to diligently and expeditiously perform their duties without delay. The distinction between these three principles, while sometimes nebulous, is in reality quite different, especially at the inception of its application.

The Statute of Limitations limits the time within which an accused may be charged with an offense, and the State may not indict after the statute has run. The basis underlying the Statute of Limitations is unreasonable delay. The same principle of unreasonable delay is embodied in the speedy trial concept of the Sixth Amendment, however, it

does not come into effect until after an indictment. Strangely enough, although the speedy trial concept is closer to the Statute of Limitations, it is the double jeopardy principle which is most often confused with the speedy trial concept.

The double jeopardy theory does not become applicable until there has once been jeopardy in the form of a jury being impaneled and sworn. Thus the Statute of Limitations is operative prior to indictment, speedy trial remedy is operative prior to trial but subsequent to indictment, and the double jeopardy remedy is used after a plea or a trial has begun. In the absence of Statutes prohibiting the re-filing of an indictment after a dismissal, Courts which hold that the indictment may be re-filed generally use the reasoning that the defendant has not been put in jeopardy. *Ex Parte Clarke*, 54 Cal. 412 is a good example of the specious reasoning used by Courts allowing re-filing of indictment after the prior indictment has been dismissed. What that case really held and what the Government must in good faith contend in opposition to this brief is: that there is a remedy for a violation of the Statute of Limitations and double jeopardy but there is no remedy if the defendant is denied the right to a speedy trial because the Government may merely re-file if the Statute of Limitations has not run. We make the forthright assertion that it would be downright tyranny to allow the Government a second chance to clang shut the prison gates on the defendant after the trial Court has held that the Government itself has violated the Sixth Amendment of the Constitution to the detriment of the defendant.

THEREFORE, we request that this Court enforce the remedy for the Government's violation of the Sixth Amendment and enter a judgment of acquittal as to all counts.

II. The Refusal of the District Court to Instruct the Jury on the Defendant's Failure to Testify Was Prejudicial Error

The Court was requested to give an instruction that the defendant does not have to take the stand and this can't be held against him, etc. (Court Ex 7).

The Court refused to give this instruction.

The facts in *Bruno v. United States* 308 U.S. 299, (Sup. Ct. 1939), are so close to the facts in the case at bar that the defendant-appellant relies exclusively upon the *Bruno* case.

Here the Court said:

> "Upon receipt of counsel's note during the argument . . . I attempted to cover counsel's position in the note by the addition of the words at the end of . . . 'including his own testimony' which was related to the fact that the defendant was not required to place any evidence at all in the case .... (1285)."

In the *Bruno* case, Supra at page 199, the Court gave a different instruction which included:

> "It is the privilege of a defendant to testify as a witness if and only when, he so elects; ...."

Thus the trial Court in *Bruno* went further than the trial Court in this case.

In *Bruno* as in the case at bar, the trial Court was of the opinion the topic was covered, *Bruno supra,* P. 298, case at bar P. 1285.

The Court in *Bruno Supra* held that the defendant had the indefeasible right to have the jury told in substance what he asked the judge to tell it; and furthermore that the failure to so instruct was not mere technical error but automatically reversible.

We request that this Court rule that it was error not to give the appellant's requested instruction and therefore, reverse and remand the case for new trial.

CONCLUSION

The appellant respectfully requests that this Court enter a judgment of acquittal on Counts 1, 2, 3, 4, 5, 6, 7, 9, 10, 11 and 12 on the grounds that the Government may not refile an indictment once it has been dismissed on the grounds of a denial of speedy trial pursuant to the Sixth Amendment to the Constitution; and thereby further abuse the Constitutional rights of the appellant.

In the alternative, the appellant respectfully requests the Court to reverse and remand this case for new trial on all counts as a result of the prejudicial error caused by the trial Court's failure and refusal to properly instruct the jury as to the defendant's failure to testify.

SHELDON GREEN
Attorney for the Appellant

CERTIFICATE

I certify that in connection with the preparation of this Brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that in my opinion the foregoing Brief is in full compliance with those rules.

SHELDON GREEN

Appendix

Exhibit	Marked	Admitted
Courts No. 7	1284	1286

NO. [redacted]

IN THE UNITED STATES COURT OF APPEALS

FOR THE NINTH CIRCUIT

THOMAS T. COHEN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLEE'S BRIEF

APPEAL FROM
THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF ARIZONA

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APPELLEE'S BRIEF

I

JURISDICTIONAL STATEMENT

The appellant Thomas T. Cohen was indicted by the Federal Grand Jury for the District of Arizona on February 27, 1963 [C. T. 74]. 1/ The indictment contained 15 counts [R. T. 36, Proceedings on July 28, 1964]. 2/ The appellant was arraigned and entered a plea of not guilty to all counts on December 30, 1963 [C. T. 74]. On January 25, 1964, appellant filed a motion to dismiss the indictment which was granted on July 28, 1964. It was further ordered that bail be continued for 60 days to allow the filing of a second

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1/ "C. T." refers to Clerk's Transcript of Record.

2/ "R. T." refers to Reporter's Transcript of Record.

indictment [R. T. 63-64, Proceedings on July 28, 1964].

The second indictment was returned and filed on September 9, 1964. The indictment contained 12 counts. The first 11 counts alleged offenses under Title 18, United States Code, Section 1341, Mail Fraud. The last count alleged a violation of Title 18, United States Code, Section 1342, Using Fictitious Name to Effect a Mail Fraud. Appellant was arraigned and entered a plea of not guilty to all counts on October 6, 1964 [C. T. 197].

On October 22, 1964, appellant filed a motion to dismiss the indictment with prejudice [C. T. 197]. On December 14, 1964, the motion to dismiss was denied [C. T. 198].

Jury trial was commenced on March 9, 1965, before the Honorable Walter E. Craig, United States District Court Judge [C. T. 201]. On March 17, 1965, the jury returned a verdict of guilty on all eleven counts that went to the jury [C. T. 202].

On May 17, 1965, appellant's motions for arrest of judgment and for judgment of acquittal or in the alternative for new trial were denied [C. T. 203].

Appellant was sentenced to 2 years imprisonment on each count, said sentences to run concurrently. The sentence imposed was made subject to the provisions of Title 18, United States Code, Section 4208(a)(2), the Court recommending that the Board of Parole consider eligibility for parole in a period not to exceed one year [C. T. 203].

The jurisdiction of the District Court rests on Sections 1341, 1342, and 3231 of Title 18, United States Code. This Court

has jurisdiction to review the judgment of the District Court pursuant to Title 28, United States Code, Sections 1291 and 1294.

II

STATUTES INVOLVED

Title 18, United States Code, Section 1341 (Mail Fraud Statute) was applicable to the first eleven counts of the indictment and provides in pertinent part as follows:

> "Whoever having devised or intending to devise any scheme or artifice to defraud, or for obtaining money or property by means of false or fraudulent pretenses, representations, or promises, . . . for the purpose of executing such scheme or artifice or attempting so to do, places in any post office or authorized depository for mail matter, any matter or thing whatever to be sent or delivered by the Post Office Department, or takes or receives therefrom, any such matter or thing, or knowingly causes to be delivered by mail according to the directions thereon, or at the place at which it is directed to be delivered by the person to whom it is addressed, any such matter or thing, shall be fined not more than $1,000 or imprisoned not more than five years, or both."

Title 18, United States Code, Section 1342 (Fictitious Name) was applicable to Count Twelve and provides in pertinent part as follows:

"Whoever for the purpose of conducting, promoting, or carrying on by means of the Post Office Department of the United States, any scheme or devise mentioned in Section 1341 of this Title . . . uses or assumes . . . any fictitious, false, or assumed title, name, or address or name other than his own proper name, or takes or receives from any Post Office or authorized depository of mail matter, any letter, postal card, package, or other mail matter addressed to any such fictitious, false, or assumed title, name or address, or name other than his own proper name, shall be fined not more than $1,000 or imprisoned not more than five years, or both."

III

STATEMENT OF FACTS

In January, 1961, appellant arrived in Phoenix, Arizona, and began using the fictitious name of "Al Sherman". To complete the facade, he created a fictional past for Al Sherman [R.T. 857-1105]. He incorporated Elderdale Estates, his solely owned shell corporation [R.T. 43-44-50, 127, 148]. Through Elderdale Estates appellant purchased a total of 280 acres of land in Utah at $19.50 an acre [R.T. 115, 123]. Thereafter, appellant incorporated Land Lists, his solely owned shell corporation [R.T. 43-45, 51, 95]. Land Lists then purchased the land from Elderdale Estates at a price of $50.00 an acre [Exhibit 6, R.T. 113].

Appellant also used Land Lists to distribute the land to the public under the guise of a giveaway program which operated in two ways. The first method was to place boxes in Phoenix, Arizona markets for the market customers to participate in an alleged drawing for a quarter acre "free" lot in "Fabulous Elderdale Estates" [R. T. 170, 176, 183-184]. The second method utilized was to place a "free" land certificate in the Lucky Family Check Book, a book containing coupons to purchase merchandise from retail stores at a discount [R. T. 457-461]. The latter method operated primarily in Pocatello, Idaho, and Missoula, Montana [R. T. 436].

Although the appellant represented that the land would be given to winners of a legitimate drawing, there was no drawing. Every participating customer, was a "winner" [R. T. 113-117, 200, 579, 593].

Although the appellant represented that the lot was free, the "winner" actually purchased the lot through the guise of closing costs for transfer of title. Thus appellant collected approximately $100 for an acre of land he originally purchased for $19.50 [R. T. 207]. To complete the aura of legitimacy, appellant created a third solely owned corporationtitled Brokers Trust to collect the closing costs for transfer of title and filing of deeds [R. T. 51, 92]. Thus, the public thought that a separate escrow company was involved. The only thing that separated Land Lists and Brokers Trust was a flight of stairs from the second floor to the first [R. T. 105, 107, 198]. To facilitate financial transactions, appellant opened two checking accounts in the name of Brokers Trust. "D.

Ritter" was the only authorized signature on the checking accounts. This was a second fictitious name utilized by appellant [R. T. 231, 696].

Appellant employed men lacking prior experience to be escrow agents for Brokers Trust. The primary function of the escrow agent was to personally contact the public, tell them about the land, and secure the closing costs. To perform this function the defendant supplied the escrow agents with various documents including brochures on "Fabulous Elderdale Estates" [Defendant's Exhibit A, R. T. 944, 1146]. Appellant or other of his employees instructed the escrow agents to make certain representations to induce the public to accept the "free lot" and pay the closing costs [R. T. 194, 195, 233-235, 465-466, 473, 639-640].

In addition to the testimony of salesmen, twenty-one winners, each of a "free" lot, testified. Five winners either saw the appellant or heard the appellant make the false representations [R. T. 154, 286, 317, 324, 340, 356-360, 370, 381, 384, 396, 498, 523, 536, 547, 587, 602, 608, 645, 650, 657, 667].

These representations included the following:

1. The land was grazing land.

This representation was false as evidenced by testimony that the land was an undried mud flat which had formerly been the basin of the great Salt Lake. There is an unchanging layer of salt covering the land, the permanency of which was attested to by the fact that approximately one-quarter of the ill-fated Donner party perished in the area and their tracks are still visible [R. T. 797-

799]. The land is worthless for grazing livestock [R. T. 730]. The only vegetation possible is salt tolerant plants such as pickleweed, salt grass, greasewood and alkali sacaton [R. T. 730-731].

2. The land had been surveyed, staked out and marked

This representation was false as evidenced by the testimony that the last survey in the area had been made by Gulf Oil in 1953 at the time of their drilling an oil well which proved to be a dry hole [R. T. 770-774].

3. Land List, Inc. planned a housing development.

This representation was false as evidenced by the fact that although the defendant's brochures regarding "Fabulous Elderdale Estates" stated that lots were for sale for $200, no lots had ever been sold. Appellant in his letter to the Better Business Bureau represented that "no other land is being sold" [Exhibit 88, R. T. 1098, 1146-1147]. In addition the very nature of the land proves that any development is unfeasible.

4. Water is available.

This representation was false as evidenced by the fact that potable water is totally unavailable on the land. The only well in the area had been drilled by the United States Department of Interior and abandoned in 1958 because the water was too brackish for even livestock [R. T. 733-734, 764-766].

5. There was a highway adjacent to the property and the individual lots were accessible by existing or soon to be built automobile roads.

This representation was false as evidenced by maps and

testimony offered which showed that there is no highway adjacent to the property owned by appellant [R. T. 1142]. The closest road to the land involved is an unimproved gravel road approximately seven and one-half miles away. There are absolutely no roads or trails on the land involved [R. T. 716-796]. The deeds granted to the land contained no restrictions or dedications for streets, roads, alleys or highways. As a result accessibility to individual lots would be available only by trespass over other lots [R. T. 679].

6. Electricity was available.

This representation was false as evidenced by the testimony that electricity was unavailable in the area and the estimated cost for bringing power to the land was $15,600.00 [R. T. 699-700].

7. Schools, churches and shopping facilities were available in the near-by towns of Pigeon and Lucin, Utah.

This representation was false as evidenced by the fact that Pigeon, Utah was not a town nor had it ever been a town. It was a railroad siding which consisted of two miles of a double set of railroad tracks [R. T. 721-722]. Lucin, Utah was also a railroad siding, which additionally had one building, being the home for the signal maintenance man employed by the Southern Pacific Railroad [R. T. 759-760].

8. Upon payment of the closing costs, the winner would receive a recorded deed.

This representation was false as evidenced by the fact that 400 deeds were unrecorded at the time appellant took flight (Exhibit 28, R. T. 229, 961].

In August, 1961, appellant told his employees that he was leaving on a business trip. He was expected to return He did not Appellant left Phoenix and a series of unpaid bills [R. T. 223, 226, 229, 961, 596]. After appellant took flight, employees and others borrowed enough money to file approximately 300 of the unrecorded deeds [R. T. 961, 268].

IV

ARGUMENT

A. DISMISSAL OF THE FIRST INDICTMENT WITH LEAVE TO RE-INDICT DOES NOT BAR A SECOND INDICTMENT FOR THE SAME OFFENSE.

From February 27, 1963, until November 8, 1963, appellant was in Federal custody in the Southern District of Florida on unrelated pending charges.

On February 27, 1963, the first mail fraud indictment in the instant case was returned in Phoenix, Arizona, and a bench warrant concurrently issued [C. T. 74]. The warrant was received by the United States Marshal for the Southern District of Florida on March 4, 1963, and executed by said Marshal on November 8, 1963 [C. T. 74]. On November 13, 1963, appellant posted bond in the instant case and was thereafter at liberty pending trial [C. T. 187]. On December 30, 1963, appellant was arraigned and entered a plea of not guilty. He filed a motion to dismiss for lack of speedy trial on January 25, 1964, and a hearing was held on

July 27 and 28, 1964 before the Honorable William C. Mathes, United States District Judge [C. T. 74-75]. At the hearing, Judge Mathes asked Government counsel "Do you have any statute of limitations problems", and whether the Government would re-indict and dismiss the first indictment. The Court stated: " . . . you represent to the Court that that will be done, I will deny this motion. But if you don't represent that it will be done, I will grant the motion." [R. T. 36-39, Proceedings on July 28, 1964]. Upon being pressed by appellant to either grant or deny the motion immediately, the Court dismissed the indictment for unnecessary delay pursuant to Rule 48 of the Federal Rules of Criminal Procedure and ordered that bail be continued for sixty days to allow the filing of a second indictment [R. T. 42, 63-64, Proceedings on July 28, 1964].

On September 9, 1964, the second indictment was returned, within the 60 days and consistent with the Court's order, and on October 6, 1964, appellant was arraigned and entered a plea of not guilty [C. T. 197]. Appellant filed a motion to dismiss with prejudice on October 22, 1964, and on December 14, 1964, the motion was denied for the reason that appellant had failed to disclose wherein he had been prejudiced and for the further reason that the prior order of dismissal was based upon the Government's failure to prosecute and did not bar a new indictment [C. T. 197-198]. Trial was set for (and did in fact commence on) March 9, 1965 [C. T. 199]. On December 23, 1964, appellant filed a notice of appeal from the December 14, 1964, denial of his motion to dismiss

with prejudice. Appellant did not perfect this appeal [C. T. 198].

Appellant does not complain of the six months delay between the second indictment and trial, rather he cites the eight and one-half month delay following the first indictment. Appellant's premise is that the dismissal of the first indictment with leave to re-indict was a bar to a second indictment for the same offense.

Rule 48 of the Federal Rules of Criminal Procedure:

> " . . . implements the constitutional guarantee of a speedy trial. See Pollard v. United States, supra, 352 U.S. 361 . . . but it goes further. As the committee note indicates, Rule 48(b) 'is a restatement of the inherent power of the Court to dismiss a case for want of prosecution,' and that power is not circumscribed by the Sixth Amendment."
>
> Mann v. United States, 304 F.2d 394, 398, (D.C. Cir. 1962).

It is clear that the rights of the defendant are not to "preclude the rights of public justice".

> Beavers v. Haubert, 198 U.S. 77, 87 (1905).

Therefore, "the right of a speedy trial is necessarily relative. It is consistent with delays and dependent upon circumstances." Beavers v. Haubert, supra, page 87.

> " ' . . . the right to a speedy trial is not designed as a sword for the defendant's escape, but rather as a shield for his protection.' " United States v. Lustman, 258 F.2d 475, 478 (2nd Cir. 1958).

When appellant filed his motion to dismiss the first indictment he cited the delay of eight months and his custody during this period, as the grounds for relief.

In a note on the right to a speedy trial, 57 Columbia Law Review (1957), it is stated that: "It appears thus far that the constitutional violation will seldom, if ever, be declared unless the delay lasts over a year." Page 852, Note 38. Thus it is clear that "speed in trying accused persons is not of itself primal or separate consideration. Justice both to the accused and the public is the prime consideration." Frankel v. Woodrough, 7 F. 2d 797 (8th Cir. 1925).

Even when a defendant did not request a speedy trial because he expected the indictment to be dismissed, this Court has held there was no violation of the constitutional guarantee of a speedy trial, which necessarily included the finding that a delay of two years was not arbitrary or oppressive.

Collins v. United States, 157 F. 2d 409 (9th Cir. 1906).

As stated in United States v. Ewell and Dennis, ___ U. S. ___, #29, Oct. Term, 1965 (February 23, 1966):

> "We cannot agree that the passage of 19 months between the original arrests and the hearings on the later indictments itself demonstrates a violation of the Sixth Amendment's guarantee of a speedy trial. This guarantee is an important safeguard to prevent undue and oppressive incarceration prior to trial, to minimize anxiety and concern accompanying public accusation and to limit the

possibilities that long delay will impair the ability of an accused to defend himself."

The oppressive incarceration referred to by the Supreme Court can only mean custody occasioned by the case wherein relief is sought. Appellant's custody did not arise from the instant case but was occasioned by unrelated charges pending in Florida. The warrant issued for the instant case was executed on November 8, 1963. Appellant posted bond and was released on November 13, 1963. Only six days of custody were occasioned by the instant case. Even assuming that the eight months custody on the pending Florida charges was invalid, this does not of itself constitute a violation of the right to speedy trial. As the Supreme Court stated " . . . there is every reason to expect the sentencing judge to take the invalid incarcerations into account in fashioning new sentences if appellees are again convicted." United States v. Ewell and Dennis, supra.

By his own statement, appellant was unaware of our indictment for eight months. Thus it did not cause any concern or anxiety to appellant.

Appellant did not complain that the delay caused unavailability of evidence, or unavailability of witnesses, or faultering memories of witnesses, or in any way impaired his right to a fair trial. "In the complete absence of any indication that the instant defendant was adversely affected in the preparation or prosecution of his defense by the lapse of time [3 years] in bringing this case to trial, we can see no ground for complaint by defendant on that

score." United States v. Holmes, 168 F. 2d 888, 891 (3rd Cir. 1948).

See also Yeaman v. United States, 326 F. 2d 273 (9th Cir. 1963).

All the foregoing factors were in existence at the time the motion to dismiss the first indictment was pending before District Court Judge William C. Mathes. A motion to dismiss an indictment based on unnecessary delay is addressed to the sound discretion of the trial court. Having in mind that appellant's complaint was passage of time and not prejudice to his defense, Judge Mathes chose to exercise his discretion with limitations. It is fundamental that a court having the power to act has the power to undo its act, therefore should a judge reverse an order of dismissal or effectively reverse an order, there is no longer a bar to a second prosecution for the same offense.

Robinson v. United States, 284 F. 2d 775
(5th Cir. 1960);
Ex Parte Altman, 34 Fed. Supp. 106 (D. C. S. D. Cal.).

Although dismissing the first indictment for failure to prosecute, Judge Mathes clearly expressed particularly in his order continuing bail to allow re-indictment that the dismissal was without prejudice to re-indictment. Therefore, " . . . the accused cannot complain because a liberal application of the Rule 48(b) earned him temporary freedom, without according him full immunity from prosecution." Mann v. United States, supra, at 398.

B. FROM THE WHOLE RECORD IT APPEARS THAT THERE WAS NO PREJUDICIAL ERROR IN JURY INSTRUCTIONS.

1. FAILURE TO OBJECT FORECLOSES THE RIGHT TO REVIEW.

At the conference on jury instructions, appellant did not request an instruction on the right of an accused not to testify [R. T. 1284-1285]. During closing argument on behalf of the Government, appellant's counsel gave an informal handwritten note to the Court Clerk which stated "I want to approach the Bench for instruction. I think I forgot to ask for instruction that defendant doesn't have to take stand and can't be held against him, etc." [R. T. 1285]. Thereafter, the Court instructed the jury. The instructions thoroughly covered the presumption of innocence, reasonable doubt and the fact that "A defendant is not to be convicted on mere suspicion or conjecture." [R. T. 1260-1261].

The Court also stated that "The law does not impose upon a defendant the duty of producing any evidence, including his own testimony." [R. T. 1261]. At the conclusion of the instructions, Counsel were called to the Bench and, outside of the hearing of the jury, the Court asked "Does either Counsel have any further instructions to offer at this time?" Government Counsel asked "What was the statement you made about failure of the defendant to take the stand?" To which the Court replied "I tacked it on, that he didn't have to present any testimony, including his own testimony."

To which Counsel for appellant replied "All right." [R. T. 1275].

After the bailiffs had been sworn and the jury had withdrawn from the courtroom to commence deliberations, appellant then withdrew his consent to the instruction and orally requested an instruction that "the defendant does not have to take the stand and that this fact cannot be held against him nor any inferences made thereto." [R. T. 1277-1278].

Rule 30 of the Federal Rules of Criminal Procedure provides in part that "No party may assign as error any portion of the charge or omission therefrom unless he objects thereto before the jury retires to consider its verdict. . . . " In the instant case appellant did not object to the instruction on the right of an accused not to testify and further, he specifically stated that it was "All right". In the absence of plain error appellant's failure to object has foreclosed the right to review.

Phillips v. United States, 334 F. 2d 589 (9th Cir. 1964), cert. den. 379 U.S. 1002.

Failure to instruct on the right of an accused not to testify, is not reversible error in the absence of a request or objection.

Pereira v. United States, 202 F. 2d 830 (5th Cir. 1953), aff'd 347 U.S. 1.

And as observed in United States v. Reiburn, 127 F. 2d 525 (2nd Cir. 1942):

> "An accused often does not wish this [defendant's failure to testify] to be even alluded to, believing that if the jury considers it at all they will inevitably use it

against him. Be that as it may, it is abundantly well-settled that the failure to give the instruction when it is not asked for is not error; at least when adequate instructions are given as to reasonable doubt and a presumption of innocence."

In many instances the giving of such an instruction has been cited as error. The Courts have held to the contrary.

United States v. Garguilo, 310 F. 2d 249 (2nd Cir. 1962);

Lyons v. United States, 284 F. 2d 237 (D.C. Cir. 1960);

Windisch v. United States, 295 F. 2d 531 (5th Cir. 1961).

Thus it is clear that the lack of an instruction on the right of an accused not to testify is not in and of itself plain error.

2. APPELLANT MUST PROPERLY REQUEST INSTRUCTIONS.

Rule 30 of the Federal Rules of Criminal Procedure provides that "at the close of the evidence, or such earlier time during the trial as the Court reasonably directs, any party may file written requests that the Court instruct the jury on the law as set forth in the requests." Appellant's only attempt at compliance with this rule was by the submission of an informal handwritten note during the Government's closing argument. It is proper for a Court to refuse to give instructions which were not handed to the

Court prior to argument of counsel.

United States v. Liss, 137 F. 2d 995 (2nd Cir. 1943), cert. den. 320 U.S. 773.

In addition, appellant's handwritten note was not, as phrased, a sufficient statement of the law. The Court can refuse to give an improperly stated instruction.

George v. United States, 125 F. 2d 559 (D.C. Cir. 1942).

3. BRUNO CASE NOT APPLICABLE.

Finally, in Langford v. United States, 178 F. 2d 49 (9th Cir. 1949), the prosecutor on two occasions in argument, directed the jury's attention to the defendant's failure to testify. Counsel for the accused had not requested an instruction on the right of the accused not to testify; but the District Court gave an instruction to this effect which was reviewed by this Court.

> "Unlike the instruction which was held to have been properly requested in Bruno v. United States, 308 U.S. 287 . . . , this one neglected to state, in so many words that the failure of the defendant to take the stand does not create any presumption against him, or that it should not enter into the discussions or deliberations of the jury."

Langford v. United States, supra, p. 54.

This Court further stated at page 55,

"Had defendant saved the point by proper objection, the instruction given would not have cured the error. But again, when given an opportunity to make their objections to the charges given, before the jury retired, counsel for defendant stated none."

In the instant case, appellant requested no instruction on the right of an accused not to testify until he submitted an informal note, containing an insufficient statement of law, during Government counsel's closing argument. After the Court instructed that the defendant need produce no evidence nor need he testify appellant agreed to the instruction as given and did not object. In no regard did the prosecutor direct the jury's attention to appellant's failure to testify. Thus it is clear that just as in Langford v. United States, the circumstances distinguish our case from Bruno v. United States [3/], and the verdict of the jury should be allowed to stand.

3/ See also Footnote 2, Smith v. United States, 268 F. 2d 416 (9th Cir. 1959).

V

CONCLUSION

For the reasons stated the judgment of the District Court should be confirmed.

Respectfully submitted,

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United States Attorney

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Special Assistant U. S. Attorney

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United States of America

[redacted]

CERTIFICATE

I certify that in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

/s/ Jo Ann Dunne

JO ANN DUNNE

No. 20426

In the

United States Court of Appeals

For the Ninth Circuit

THOMAS T. COHEN,
Appellant,

vs.

UNITED STATES OF AMERICA,
Appellee.

On Appeal from the United States District Court for the District of Arizona

Reply Brief for Appellant

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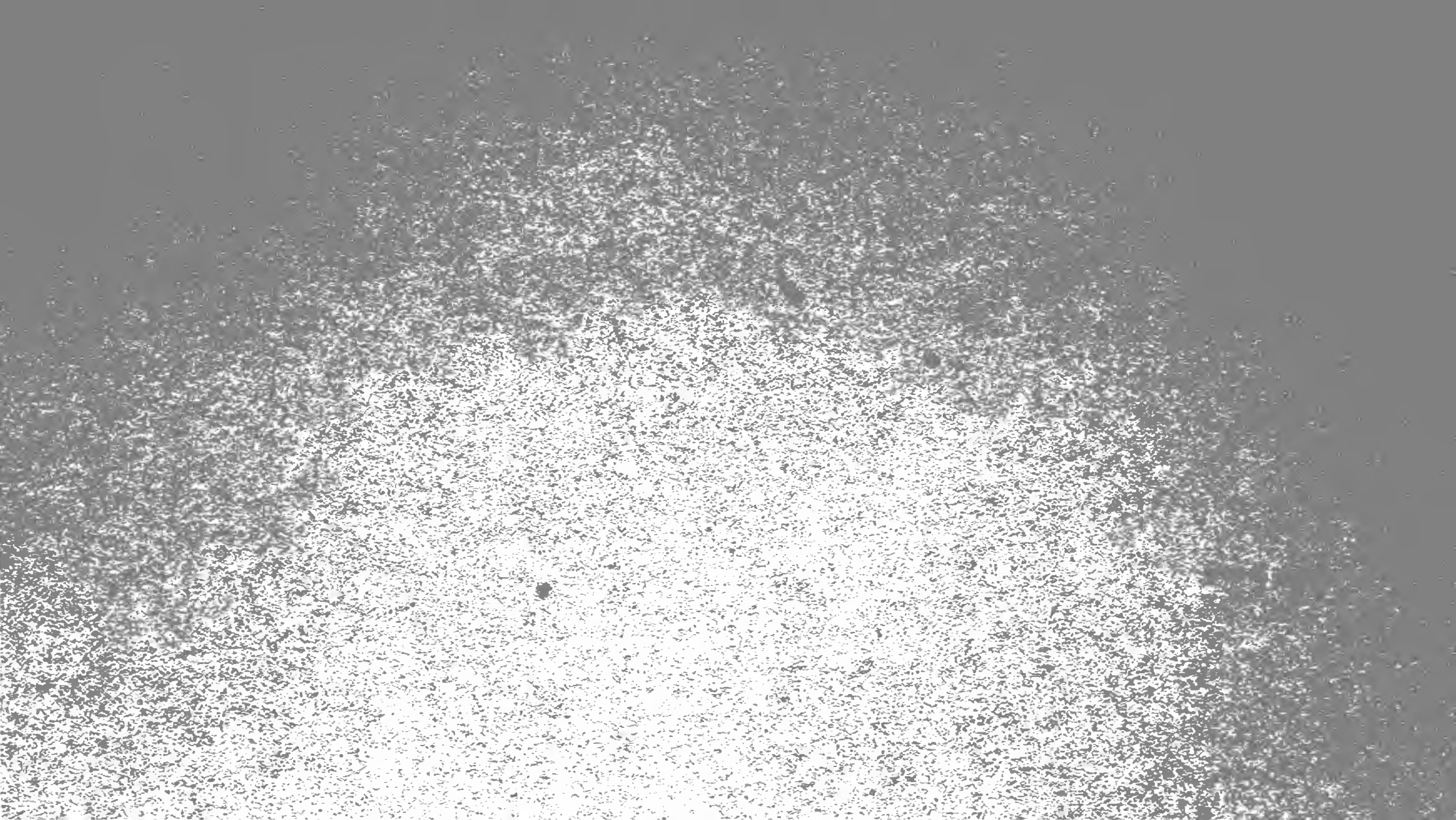

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No. 20426

In the

United States Court of Appeals

For the Ninth Circuit

THOMAS T. COHEN,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

On Appeal from the United States District Court for the District of Arizona

Reply Brief for Appellant

JURISDICTIONAL STATEMENT

The appellant, Thomas T. Cohen, was found guilty on March 17, 1965, by a jury, of ten counts of mail fraud, Sec. 1341, Title 18 U.S.C., and one count of using a fictitious name in support of the scheme to defraud, Sec. 1342, Title 18, U.S.C. Timely motions for a judgment of acquittal and for a new trial were filed. Same were denied on May 17, 1965, at which time the Court sentenced the appellant to two years each on Counts 1, 2, 3, 4, 5, 6, 7, 9, 10, 11 and 12 (count 8 having been dismissed), the sentences to run concurrently. The Court also ordered the defendant to be eligible for parole pursuant to Title 18, U.S. Code, Section 4208A (2).

The matter is before this Court pursuant to Title 28, U.S. Code, Section 1291.

REPLY TO APPELLEE'S ARGUMENT THAT DISMISSAL OF THE FIRST INDICTMENT DOES NOT BAR A SECOND INDICTMENT FOR THE SAME OFFENSE.

The appellee makes the point that an appeal from the order denying the motion to dismiss on the second indictment was not perfected (pages 10 and 11, Appellee's Brief). This is, of course, so. Although a notice of appeal was filed; it was immediately determined that a denial of a motion to dismiss an indictment was and is not a "final decision" within the statute conferring jurisdiction of appeals from final decisions of Federal District courts upon the Court of Appeals. Therefore, the denial to dismiss an indictment is not reviewable until there has been a judgment. *Atlantic Fisherman's Union v. U. S.*, 197 F.2d 519; *Conway v. U. S.*, 142 F.2d 202; *Tudor v. U. S.*, 142 F.2d 6.

The grounding basis of the appellee's opposition to the opening brief of the appellant is that the order dismissing the indictment, because every sense of the right to speedy trial pursuant to the Sixth Amendment was violated (T. of T., July 28, 1964, T. of R. Vol. 1, pages 72 and 73), should never have been granted in the first place (Appellee's Brief, pages 11-14). The Government could well have appealed that order directly to the Supreme Court, 18 U.S.C. Section 3731. This the Government chose not to do. Since their appeal from that order has been precluded by the passage of time, the appellee now tries for its second bite out of the apple by attempting to make the issue whether or not Judge Mathes' first order dismissing the indictment was initially correct. This is attempting to argue an issue not properly before this Court. Nevertheless, we have chosen to reply to some of the authorities in the Government's brief. The appellee relies upon *United States v. Ewell and Dennis,* ..... U.S. ....., No. 29 Oct. Term 1965, (February 23, 1966), 34 U.S. Law Week 4154. Once again, the Government is

arguing whether or not the initial dismissal was proper. In the *Ewell* case, supra, the indictments of Ewell and Dennis were dismissed for being defective by the District Court on January 13 and April 13, 1964, respectively. Ewell and Dennis *were immediately re arrested* (emphasis ours) on new complaints and reindicted on March 26, 1964 and June 15, 1964, respectively. Therefore, the *Ewell* case, supra, is not applicable because it was a direct appeal of the order dismissing the indictments for lack of speedy trial, and furthermore, the defendants were immediately (or at any rate within sixty days) advised of the new charges against them. In the case at bar it was more than eight months before the appellant was notified of the charges against him. Furthermore, Ewell and Dennis had known for several years of the charges against them as they had pleaded guilty to the initial charges.

The appellee makes the point that the appellant did not complain that the delay prejudiced him in any way (Appellee's Brief, page 13). We maintain that although the law may be somewhat unclear as to whether under the Sixth Amendment the Government had the burden of showing in the District Court that the defendant was not prejudiced by a delay; our reading of *Petition of Provoo*, 17 F.R.D. 183, 203 (D. Md.), affirmed 350 U.S. 857; *Taylor v. U. S.*, 238 F.2d 259 (C.A.D.C.); *United States v. Lustman*, 285 F.2d 475, 478 (C.A. 2), cert. den. 358 U.S. 880, and *Williams v United States*, 250 F.2d 19, 21 (C.A.D.C.), indicates that the Government bears this burden. In any event, the Government made no such showing, and it is clear that the trial court found as a matter of fact that there was prejudice to the defendant which denied him his right to a speedy trial.

The defendant is prejudiced by the harassment of a second criminal proceeding against him and the accompanying

No. 20427

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LOCAL UNION NO. 11, INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS, AFL-CIO,

Appellant,

vs.

G. P. THOMPSON ELECTRIC, INC.,

Appellee.

APPELLANT'S OPENING BRIEF.

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No. 20427

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LOCAL UNION NO. 11, INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS, AFL-CIO,

Appellant,

vs.

G. P. THOMPSON ELECTRIC, INC.,

Appellee.

APPELLANT'S OPENING BRIEF.

Jurisdictional Statement.

This is an appeal from a judgment of the District Court for the Southern District of California which vacated, in part, an arbitration award [R. 92].

The appellant initiated this action in the Superior Court for the County of Los Angeles [R. 5] to confirm an arbitration award under section 301(a) of the Labor Management Relations Act, 61 Stat. 156 [29 U.S.C. §185(a)] (the LMRA). Acting on authority of 28 U.S.C. §1441(b), the appellee removed the action to the District Court as a matter of which that Court had original jurisdiction under 28 U.S.C. §1337 and section 301-(a) of the LMRA [R. 3].

Timely notice of appeal was filed below [R. 95], and this Court's jurisdiction rests on 28 U.S.C. §1291.

Statement of Facts.

The appellant, Local Union No. 11, International Brotherhood of Electrical Workers, AFL-CIO (the Union), is a labor organization within the meaning of the LMRA [R. 87, ¶2; R. 88, ¶3]. G. P. Thompson Electric, Inc. (the Employer) is the appellee and is an employer in an industry affecting commerce within the meaning of the LMRA [R. 88, ¶¶ 4-6].

Pursuant to section 301(a) of the LMRA, a suit to confirm an arbitration award was brought by the Union against the Employer [R. 5]. Upon cross motions based upon section 9 of the United States Arbitration Act [9 U.S.C. §9], the Union and the Employer respectively moved to confirm and vacate the arbitration award [R. 30; R. 77]. The District Court denied in part the motion to confirm, granted in part the motion to vacate, and granted judgment accordingly [R. 92-93].

The arbitration award [R. 20] had been rendered on March 8, 1965 by the Joint Electrical Industry Committee (the JEIC), a committee created pursuant to the parties' collective bargaining agreement, and composed of equal numbers of Union representatives and representatives of the Employer [R. 12, art. I, §5]. The award was based upon a grievance filed with the JEIC by the Union and upon a hearing held by the JEIC on December 18, 1964 [R. 21]. That part of the decision of the JEIC which was vacated held that the Employer had failed to make certain payments to the Union's Pension Trust Fund and Apprenticeship and Journeyman Training Trust Fund for the months of July through October 1964, and ordered the Employer to make the appropriate payments [R. 22].

In its answer to the Union's petition to confirm the award, the Employer contended, among other things, that the award contained claims which the Union should have asserted as compulsory counterclaims in a previous action between the parties relating to the validity of the trust funds [R. 35-36], and the Union's failure to have asserted these claims was alleged to constitute a waiver under Federal Rule of Civil Procedure 13(a).

This defense was accepted by the District Court as the basis for vacating that part of the arbitration award which required the Employer to make trust fund payments [R. 85]. The Court found that subsequent to the date these payments were due to the respective trust funds, an action was filed against the Union, with the Employer as one of the plaintiffs [R. 88-89, ¶¶8-9], in which the legality of both of the trust funds were attacked under section 302 of the LMRA [R. 42-43, ¶10(a), (b); R. 43, ¶12].[1] It was further found that the Union did not assert in the Employer's suit a counterclaim for the amounts due to the trust funds.

To the extent that the JEIC ordered the Employer to make payments to the trust fund, the District Court found in the present case that the JEIC exceeded its authority, on the ground that these amounts were compulsory counterclaims which the Union had waived. Part of the arbitration award was then confirmed by the Court [R. 93, ¶2]; however, that part which related to trust fund payments was vacated [*id.*, ¶1].

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[1]The trusts funds were found to be lawful [R. 60-65]. *Auten v. Local 11, Int'l Bhd. of Elec. Workers*, 58 LRRM 2531 (S.D. Cal. 1965).

Specification of Error Relied on, and Question Presented.

The sole error made by the District Court was its ruling that the Union had a claim against the Employer for payments to the Union's trust funds at the time the Union filed its answer in the parties' previous litigation [R. 89, ¶12]. The question presented by this appeal is whether an arbitrable grievance is required to be asserted as a compulsory counterclaim in a lawsuit.

Summary of Argument.

The collective bargaining agreement between the parties provides for the arbitration of disputes which cannot be amicably adjusted. At the time the Union filed its answer in the first lawsuit, it had only a *grievance* against the Employer which it was entitled and required to process through arbitration in accordance with the parties' contract. Until such arbitration took place and an award issued, there was no claim justiciable by a court. Since an award was not rendered until some time subsequent to the judgment in the prior suit, the Union did not, at the time it filed its answer, have any "claims" which it was required to file as counterclaims.

ARGUMENT.

The Union Did Not Have Claims Which Could Have Been Asserted at the Time the Employer Sued the Union, and Thus Did Not Have Compulsory Counterclaims.

The District Court concluded that the Union had compulsory counterclaims which it waived by not asserting in the Employer's previous suit. Under Rule 13(a) of the Federal Rules of Civil Procedure, a compulsory counterclaim is one

> "which at the time of serving the pleading the pleader has against any opposing party, if it arises out of the transaction or occurrence that is the subject matter of the opposing party's claim . . . ."

The parties' agreement provides for the payment of certain sums by the Employer to the two trust funds mentioned in the award. Article I, section 5(a) of the agreement [R. 12] (which is reproduced in Appendix A of this brief) states that "the Joint Electrical Industry Committee is authorized to function as an Arbitration Board for all matters concerning questions, interpretations, disputes or violations of this Collective Bargaining Agreement."[2] In section 6 of the same article, the parties are directed to take to the JEIC "*all* grievances or questions in dispute" which cannot be amicably settled (emphasis added).[3]

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[2]The "final and binding" award of such a committee [R. 12, art. I, §8] is enforceable under section 301(a) of the LMRA. *General Drivers v. Riss & Co.*, 372 U.S. 517 (1963).

[3]The dispute over whether the Employer was in default in his trust fund payments was of course, arbitrable. See, *e.g.*, *Association of Industrial Scientists v. Shell Dev. Co.*, 348 F.2d 385 (9th Cir. 1965); *Desert Coca Cola Co. v. General Sales Drivers*, 335 F.2d 198 (9th Cir. 1965). Further, this issue was not raised by the Employer.

Before the Union could assert in court a claim against the Employer for an alleged violation of the Employer's duty to make payments to the trust funds, the Union was obligated both by contract and by federal law to process its dispute through the collective bargaining agreement's grievance procedure.

E.g., Republic Steel Corp. v. Maddox, 379 U.S. 650 (1965) (employee may not bring action against employer for severance pay wothout exhausting grievance procedure);

Drake Bakeries, Inc. v. Local 50, American Bakery Workers, 370 U.S. 254 (1962) (employer may not sue union for damages for strike in breach of contract without exhausting grievance procedure);

Bonnot v. Congress of Independent Unions, 331 F.2d 355 (8th Cir. 1964) (union's suit against employer dismissed for failure to exhaust grievance procedure).

Not only did the Union have a *duty* to file a grievance rather than a lawsuit, but it had a *right* to have its grievance processed through "the means chosen by the parties for settlement of their differences under [the] collective bargaining agreement."

United Steelworkers v. American Mfg. Co., 363 U.S. 564, 566 (1960).

The arbitration award upon which the present suit is based was not rendered until March 8, 1965 (almost one month after the decision in the previous litigation [R. 60]); therefore, the Union did not have a "claim" against the Employer which it either could have asserted or was required to assert at the time it filed its answer in the previous case. "Claim" has variously been described as "a cause of action," *School Dist. No. 5 v.*

Lundgren, 259 F.2d 101, 104 (9th Cir. 1958), or "the aggregate of operative facts which give rise to a right enforceable in the courts," *Dery v. Wyer*, 265 F.2d 804, 807 (2d Cir. 1959). Since federal law requires that a party exhaust his contractual grievance procedures before coming to court, no "claim" would exist until such exhaustion took place.[4]

Conceivably, a "claim" inhered in the trustees of the respective trust funds at the time the Employer filed its suit. Under article VII, section 2 of the agreement [R. 18] a "legal action" to enforce collection is authorized without the necessity of utilizing the contract's grievance procedure; however, such action is limited to the trustees or their designated assignee or agent. The trustees were not parties to the prior litigation, and the Union was neither the trustees' assignee nor their agent. The Union's sole source of relief, therefore, was through the means it pursued.

Conclusion.

The District Court confirmed part of the arbitration award. That part which it vacated related solely to trust fund payments.

Other than the defense of compulsory counterclaims, each of the Employer's other defenses or grounds for

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[4]Even in ordinary contract law, one of the required allegations for a claim for breach of contract, is that all conditions precedent have been performed. *See Halprin v. Babbitt*, 303 F.2d 138, 140 (1st Cir. 1962); *Marquardt-Glenn Corp. v. Lumelite Corp.*, 11 F.R.D. 175, 176 (S.D.N.Y. 1951); *Leacis v. Foppiano*, 150 Cal.App.2d 752, 755 (1957); 2 Moore, Federal Practice ¶8.17[6] at 1762-63 (2d ed. 1964); Cal. Civ. Code §1439; *cf.* Fed. R. Civ. Proc. Form No. 12 (¶3). The Union could not truthfully have alleged that it had exhausted the grievance procedure of the parties' contract.

See also Fed. R. Civ. Proc. 13(e), which by implication recognizes the existence of "immature" claims.

having the award vacated, had they been accepted by the Court, would have been a basis for setting aside the *entire* award.[5] Only the defense of compulsory counterclaims was a basis for vacating the award *in part*. Implict, therefore, in the Court's judgment is a rejection of the Employer's other defenses or grounds; and since no appeal was filed by the Employer, the Court's implicit findings are conclusive.

The only issue before this Court is one of law: Whether an arbitrable grievance is required to be asserted as a compulsory counterclaim in a lawsuit. Clearly, federal policy under section 301(a) of the LMRA dicates a negative answer. This being so, and all of the Employer's other defenses having been conclusively ruled upon adversely to it, an order should issue directing the District Court to confirm the arbitration award.

Respectfully submitted

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[5]These grounds were (1) that the Employer was not bound to the collective bargaining agreement [R. 79, ¶9]; (2) that it did not receive adequate notice of the arbitration hearing [*id.*, ¶10]; and (3) that the arbitrators were guilty of partiality [*id.*, ¶11].

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JULIUS REICH

APPENDIX A.

Article I.
Joint Electrical Industry Committee.

Sec. 5. There shall be a Joint Electrical Industry Committee of three (3) representatives of the Employer, and three (3) representatives of the Union. It shall meet regularly at such stated times as it may decide. However, it shall also meet within 48 hours when notice is given by either party. It shall select its own Chairman and Secretary.

Sec. 5 (a). The Joint Electrical Industry Committee is authorized to function as an Arbitration Board for all matters concerning questions, interpretations, disputes or violations of this Collective Bargaining Agreement. This authority shall include the invoking of identifiable monetary damages, where appropriate, against contractors for violations of the referral procedure, wage scale, fringe benefits and subcontracting provisions of this Agreement that result in identifiable monetary damages being incurred by an employee covered by this Agreement. Damages may only be invoked by the Joint Electrical Industry Committee and shall be by majority decision of the Committee.

All monetary damages invoked against a contractor shall be used to provide awards to indentifiable injured parties. The duties of the Joint Electrical Industry Committee in respect to the Inside Wiremen's Agreement shall be that of making determinations under the provisions of this Agreement, and in no event shall it have authority to terminate, change, alter or abrogate this Agreement or its provisions.

Sec. 6. All grievances or questions in dispute shall first be taken up for adjustment by the duly selected representatives of both parties to this Agreement. In the event these two representatives are unable to adjust any matter within 48 hours, they shall refer same to the Joint Electrical Industry Committee.

Sec. 7. A meeting shall be called at the earliest possible date. Should this Committee fail to agree or to adjust any matters within eight (8) calendar days of the first meeting, such shall then be referred to the "Council on Industrial Relations for the Electrical Contracting Industry of the United States and Canada." The Council's decision shall be final and binding.

Sec. 8. All matters coming before the Committee shall be decided by a majority vote. This decision shall be final and binding. Two (2) from each, the Union and the employers, shall be a quorum for the transaction of business, but each party shall have the right to cast the full vote of its membership, and it shall be counted as though all were present and voting.

Sec. 9. When any matter in dispute has been referred to the Joint Electrical Industry Committee or the "Council on Industrial Relations for the Electrical Contracting Industry of the United States and Canada" for adjustment, the provisions and conditions prevailing prior to the time such matter arose shall not be changed or abrogated until the decision is rendered.

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Appellant,

vs.

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Appellee.

BRIEF FOR APPELLEE.

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Appellant,

vs.

G. P. THOMPSON ELECTRIC, INC.,

Appellee.

BRIEF FOR APPELLEE.

Jurisdictional Statement.

This action involves proceedings to confirm and to vacate an arbitration award under Section 301(a) of the Labor Management Relations Act, 29 U.S.C. § 185(a). The proceeding was commenced in the Superior Court of the State of California. Appellee removed the action to the United States District Court for the Southern District of California by virtue of 28 U.S.C. § 1441(b). The District Court had original jurisdiction, 28 U.S.C. § 1337 and 29 U.S.C. § 185(a). An appeal was filed [R. 95] and the jurisdiction of this court rests on 28 U.S.C. § 1291.

Statement of the Case.

Appellant commenced this proceeding in the Superior Court for the State of California to enforce an arbitration award. The award, among other things, required

appellee to make payments into two trust funds. Through the state court enforcement proceeding appellant sought a money judgment against appellee in the amount allegedly owing into the trust funds. California Code of Civil Procedure, Section 1287.4; *Los Angeles Local Joint Executive Board of Culinary Workers and Bartenders, AFL v. Stan's Drive Ins, Inc.,* 136 Cal. App. 2d 95 (1955)

The proceeding was then removed by Appellee to the United States District Court pursuant to the provisions of 28 U.S.C. § 1441.

Appellee then petitioned to vacate that portion of the award requiring payment into the trust funds on the ground that the claims there asserted by appellant were claims which existed in favor of appellant and against appellee at the time of a prior action between the parties[1] and that they had been waived by appellant's failure to assert them in the prior action as required by Rule 13(a) of the Federal Rules of Civil Procedure.

The Court below vacated the portion of the award pertaining to the trust fund payments on this ground.

The sole issue on this appeal is whether the claims for the payment of money into the trust funds, on which appellant seeks a money judgment in this proceeding, were compulsory counterclaims which appellant waived by failing to assert them in the prior action between the parties. There appear to be no appellate decisions directly answering this question.

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[1] *Auten v. Local Union No. 11* in which appellee was a plaintiff and appellant was defendant.

Summary of Argument.

The appellant had a claim arising from the same transaction or occurrence litigated in a prior action between the parties. Though the claim might have been asserted through arbitration proceeding, it was required to be asserted in the prior action under the *rationale* of the recent arbitration requirement cases, the Federal Rules of Civil Procedure and the Labor Management Relations Act. Appellant was authorized by the collective bargaining agreement, the Labor Management Relations Act and common principles of law to assert such claims in the prior action. The claims are no less claims in a court of law, than at an arbitration proceeding. The requirements of the recent federal cases to process claims through arbitration before going to a court of law arise only in the context of some party objecting to the prosecution of the action in court, and do not include instances when a federal rule of procedure of long standing must be sacrificed to encourage dilatory tactics on the part of appellant.

I.

The Union Had a Claim That Arose From the Same Occurrence or Transaction Litigated in a Prior Case and Was a Compulsory Counterclaim in That Case.

It is appellee's position, and the trial court found, that the claims upon which appellant now seeks a money judgment were claims which have been waived by appellant's failure to assert them in the prior proceeding.

It is apparently appellant's position that there could be no claim until an arbitration decision was rendered. Appellant states that since arbitration was required, the

recent Supreme Court cases would not allow an action on the claims[2] in Federal Court.[3] Thus, appellant argues it had no claim to assert in the prior proceeding. The first great weakness in this argument is that it fails to consider the purposes and rationale of the very decisions upon which appellant relies. The second great weakness in this argument is that it fails to consider the purposes and rationale of Rule 13(a), of the Federal Rules of Civil Procedure.

Absent an arbitration provision, the appellant could have commenced an action in the District Court for its claim for moneys due.[4]

The purpose of the salutory recent rulings regarding submission to arbitration, when the dispute is arbitrable, is to prevent industrial strife.[5] Arbitration, appellee agrees is a desirable thing. Arbitration is not always an end in itself. This very cause commenced as an action to confirm an arbitration award under Section 301(a) LMRA.[6] The rationale of the arbitration requirement cases is for rapid, effective settlement of disputes. This,

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[2]Appellant, one assumes, would admit to having a claim to be arbitrated; even if that claim is not a claim, by appellant's reasoning, for all purposes.

[3]*Republic Steel Corp. v. Maddox,* 379 U.S. 650 (1965); *Drake Bakeries, Inc. v. Local 50, American Bakery Workers,* 370 U.S. 254 (1962); *United Steelworkers v. American Mfg. Co.,* 363 U.S. 564 (1960). Of course the rule applies as well to unions' failure to arbitrate, *Bonnot v. Congress of Independent Unions,* 331 F. 2d 355 (8th Cir. 1964).

[4]Section 301, Labor Management Relations Act. Appellant argues that only the trustees of the respective trust funds could have brought the action for the claim. That contention is, of course, without merit, and is answered in II, p. 9, *infra.*

[5]Arbitration is the substitute for industrial strife." *United Steelworkers of America, AFL-CIO v. Warrior & Gulf Nav. Co.,* 363 U.S. 574, 578 (1960).

[6]See also 9 U.S.C. §9.

unfortunately, is not always the case, since the arbitration decisions often require court enforcement, thus unavoidably prolonging the dispute.

If a lessening of court confrontations and speedy disposition of disputes will lead to industrial harmony, surely the principles behind Rule 13(a) take on even more force. A long-standing federal rule, now embodied in Rule 13(a), is designed to eliminate multiplicity of lawsuits and bring about speedy disposition of the litigant's claims. As the Second Circuit stated in *United States v. Eastport Steamship Corporation*, 255 F. 2d 795, 805 (2d Cir. 1958):

> "The underlying purpose of the rule is to force disposition in one action of all claims which have arisen between the parties to that litigation [citation omitted]. To accomplish this purpose claims not otherwise suable in a Federal Court are compelled to be the subject of a counterclaim to a cause of action properly brought in a Federal Court [citation omitted]. And also whenever a compulsory counterclaim is not pleaded in an action when it should have been pleaded the judgment entered in that action is clearly *res judicata* as to the merits of the unpleaded counterclaim. Ancillary jurisdiction is necessary to make the rule universal. The *res judicata* result is necessary to make the rule effective. Not otherwise would multiplicity of suits be avoided." (255 F. 2d at 805).

See also *Southern Construction Co. v. United States*, 371 U.S. 57, 60 (1962). In *Union Paving Co. v. Downer Corp.*, 276 F. 2d 468 (9th Cir. 1960) this court stated:

> "If a party fails to plead these causes of action as counterclaims, he is held to have waived them

> and is precluded by res judicata from ever suing on them again [citations omitted]. The apparent purpose of such compulsion is to prevent a multiplicity of lawsuits." (276 F. 2d at 470).

The policies involved in both the recent arbitration decisions and Rule 13(a) of the Federal Rules of Civil Procedure, argue for a lessening of litigation and speedy determination of issues affecting and disrupting industrial harmony. This case is one of first impression; but the issue is fairly stated as whether an over-technical following of the arbitration decisions should be allowed to defeat the purpose of those decisions and destroy a part of a long-standing federal rule of procedure. The court below reasoned that the national labor policies were best served by requiring a speedy disposition of all the issues in a given transaction at the first opportunity.

This court in a labor matter has applied Rule 13(a) to penalize dilatory tactics on the part of a labor union. In *Brotherhood of Locomotive F. & E. v. Butte, A. & P. Ry. Co.,* 286 F. 2d 706 (9th Cir. 1961), cert. den. 366 U.S. 929, the railroad announced that work previously done by members of the Brotherhood of Locomotive Firemen & Engineers would be done by employees of the parent corporation, Anaconda Company, represented by the International Union of Mine, Mill and Smelter Workers. The brotherhood issued a strike notice. The railway's injunction forbidding the strike, granted by a Montana State court, was dissolved, after removal to the United States District Court, by that court. The District Court action was upheld on appeal, 268 F. 2d 54, cert. den. 361 U.S. 864. However, before oral argument in the appeal, the International Union and

its local obtained a restraining order from a Montana State court which prohibited Anaconda Company from assigning the work in question to members of the Brotherhood.

The Brotherhood then sought restoration of the *status quo ante* by filing a supplemental answer and counterclaim in the United States District Court, District of Montana. This court held in affirming the trial court:

> "The 'restoration' claim arises out of the same transaction as the claim for an injunction, and it would not require for its adjudication the presence of any third party over whom the court would be unable to acquire jurisdiction. Such a claim must, under Rule 13(a), be included in the original pleading; if it is not, it is lost and cannot later be asserted." (286 F. 2d at 709-710.)

This court was sound in reasoning that the speedy disposition of such claims by unions must be decided at the earliest opportunity.

Appellant does not argue that the claim not asserted was not from the same transaction or occurrence. There is no doubt that it was.[7] *Auten v. Local 11, IBEW*, Case No. 64-1670-JWC, 58 LRRM 2531 (1965) determined the validity of the funds and employer payment requirements into the funds in question, and, of course, the claim not asserted until this cause is for those same

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[7]The requirement is: "a very definite logical relationship between the counterclaim and main action and . . . consequently both claims must be deemed to have arisen from the same transaction or occurrence." *Union Paving Co. v. Downer Corp.*, 276 F. 2d at 470. See also *Moore v. New York Cotton Exchange*, 270 U.S. 593 (1926).

payments. In short, one is hard-pressed to conceive a more logical relationship.[8]

A careful examination of the decisions relied on by appellant for the proposition that the arbitration provisions of a collective bargaining agreement must be adhered to reveal no such case as ours. This is *not* a question of commencing a cause in the Federal Courts before arbitration is had, but rather complying with the mandate of Rule 13(a) of the Federal Rules in a cause already before the court so as to avoid multiplicity of litigation. The union cannot deny that there are now two lawsuits where one would have sufficed, and virtually the same issues have been litigated twice.

The cases relied upon by appellant arise in the context of a party atttmpting to by-pass the arbitration table followed by an objection by the other party or parties concerned. No case has gone so far as to require arbitration when there is no objection from any party. Present a duty to counterclaim under the Federal rules, and absent any objection to such speedy disposition of the dispute the cases relied upon by appellant lose their force and reason.

The parties may waive an arbitration provision, *American Locomotive Co. v. Gyro Process, et al.,* 185 F. 2d 316 (6th Cir. 1950), so it can hardly follow that no civil action mayzbe brought under § 301(a), LMRA absent arbitration, else any action at all might be precluded.

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[8]It is unquestioned that a suit contesting the validity of an insurance policy requires a counterclaim for the benefits thereunder, Federal Rules of Civil Procedure § 13(a), *Aetna Life Insurance Co. v. Little Rock Basket Co.,* 14 FRD 381 (E.D. Ark. 1953), *Union Central Life Ins. Co. v. Burger,* 27 F. Supp. 554 (S.D.N.Y. 1939), 3 Moore Federal Practice § 13.13 (2d Ed. 1964).

It is absurd to argue that there was no "claim." It would be a triumph of form over substance to hold that the only "claim" was to go to arbitration. The arbitration process was merely the manner in which appellant erroneously chose to assert its "claim." In the usual case, postponement of the litigation until the claim is arbitrated is required by court decisions. This is not the usual case and Federal Rule 13(a) should overcome the general line of cases, and be applied by this court. *Hancock Oil Co. v. Universal Oil Products Co.*, 115 F. 2d 45 (9th Cir. 1940). To do so, would support the reasoning of both the arbitration cases and Section 13(a) of the Federal Rules of Civil Procedure.

II.

The Union Could Have Filed Counterclaims for Payments by the Employer to the Respective Trust Funds in the United States District Court.

Article VII, Section 2 of the collective bargaining agreement [R. 18] reads in part:

> "Collection actions may be brought by the Trustees of the Fund in the name of the fund. . . ."

The word "may" hardly can be read to limit the action, so as to exclude the union from bringing a suit in Federal Court when Section 301(a) LMRA specifically authorizes such a suit.[9] If the trustees chose not to sue, the union might under § 301, LMRA. It is strange indeed to find a representative of employees so willing to cast off the duties and obligations of that representation!

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[9] "May" is, of course, discretionary. *People v. Durbin*, 218 Cal. App. 2d 846 (1963).

Appellant's argument is inane in view of the *Auten* case. There the employer *et al.* sued the union regarding these very trusts. The union, at that time, was not moved to raise the issue of whether the trustees were an indispensable party, Rule 19, Federal Rules of Civil Procedure. The union can hardly argue now that it ought not to have defended when it did. This action concerns a dontract between the union and this employer, plain and simple. The union has defended the prior action without the trustees. The union proceeded to arbitration without the trustees. The union has petitioned for enforcement of the arbitration award without the trustees.

If petitioning for enforcement is not enforcing a legal claim; what is it? Yet, the union avers it could not enter court outright to enforce a legal claim for moneys due the trustee. The answer perhaps is best summed up, by merely saying it has done it, and it is authorized to do it; but it did not do it, when it could have,[10] and should have.[11]

III.

Conclusion.

For the reasons stated above appellee requests this court to affirm the entire decision of the District Court below.

Respectfully submitted,

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[10]§ 301(a) LMRA.

[11]Federal Rules of Civil Procedure § 13(a).

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

DAVID A. MADDUX

No. 20427

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

LOCAL UNION NO. 11, INTERNATIONAL BROTHERHOOD OF ELECTRICAL WORKERS, AFL-CIO,

Appellant,

vs.

G. P. THOMPSON ELECTRIC, INC.,

Appellee.

APPELLANT'S REPLY BRIEF.

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APPELLANT'S REPLY BRIEF.

Judging from the Employer's brief, at stake in this case is only a minor procedural problem which turns on whether the reduction-in-litigation policy of Rule 13(a) of the Federal Rules of Civil Procedure is to be furthered or thwarted. In actuality, however, the result of sustaining the decision of the District Court would be to stultify the National policy which requires parties to process grievances through arbitration where they have contractually agreed to do so.

The District Court's decision resulted in a forfeiture by the Union of an admittedly arbitrable grievance, simply because the Union failed to assert its grievance as a counterclaim to an action initiated by the Employer.

Upon the following chain of reasoning rests the Employer's entire case in support of the District Court's decision: parties may waive their right to arbitrate and

may instead submit their disputes to a court for determination; the Union was not required to submit its dispute with the Employer to arbitration; *ergo,* the Union's failure to assert as a counterclaim its arbitrable grievance constituted a waiver of that grievance.

While we agree that the right to arbitrate *may* be waived in favor of litigating a claim, it does not follow that it *must* be waived. Yet it is on this single proposition, namely, that the Union was *required* to waive its arbitrable grievance and present that grievance as a counterclaim in a court action, that the Employer's defense of the District Court's decision rests.

No case has been cited which is on point (none of those cited in the Brief for Appellee involved a counterclaim which consisted of an arbitrable grievance); and indeed, it would be astonishing to find such a case since it would run counter to Supreme Court-enunciated policy of six years' standing. Specifically, in the Supreme Court's arbitration trilogy, *United Steelworkers v. Enterprise Wheel & Car Corp.,* 363 U.S. 593, 4 L.Ed.2d 1424 (1960); *United Steelworkers v. Warrior & Gulf Nav. Co.,* 363 U.S. 574, 4 L.Ed.2d 1409 (1960); *United Steelworkers v. American Mfg. Co.,* 363 U.S. 564, 4 L.Ed.2d 1403 (1960), the lower federal courts were directed to look with favor upon arbitration as a means of settling disputes; and they were admonished to exclude from arbitration only those disputes which the parties expressly agreed should not be arbitrated, *United Steelworkers v. Warrior & Gulf Nav. Co.,* 363 U.S. at 581, 582-83, 4 L.Ed.2d at 1417; see *Desert Coca Cola Bottling Co. v. General Sales Drivers,* 335 F.2d 198, 201 (9th Cir. 1964). The same policy has also been made applicable to the States, *Local 174, Teamsters v. Lucas*

Flour Co., 369 U.S. 95, 102-03, 7 L.Ed.2d 593, 598 (1962).

Since the arbitration trilogy, the Supreme Court has on numerous occasions remanded arbitrable disputes to the parties' grievance adjustment processes where one of the parties sought to have the dispute litigated in court. For example, where an employer sought damages for breach of contract, alleging that the union had actually repudiated the agreement by striking in the face of a no strike pledge and had thus waived its right to demand arbitration, the Supreme Court nevertheless stayed the court proceeding and required the employer to seek its remedy by way of arbitration. *Drake Bakeries, Inc. v. Local 50, American Bakery Workers*, 370 U.S. 254, 260-62, 8 L.Ed.2d 474, 479-80 (1962). The Supreme Court ruled, in *Drake Bakeries*, that the strike action was not "such a breach or repudiation of the arbitration clause by the union that the company is excused from arbitrating, upon theories of waiver, estoppel, or otherwise," *id.*, 370 U.S. at 262, 8 L.Ed.2d at 480.

Yet the Employer in this case would find a waiver from the fact that the Union *could*, if it wished, have waived its right to arbitrate.

Were the District Court's decision sustained, it would create a novel exception to the National policy which states that a party desiring to arbitrate an arbitrable dispute is entitled to utilize that forum and need not have his grievance adjudicated by a court.[1]

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[1]The Union bargained to have an arbitration board decide "all matters concerning questions, interpretations, disputes or violations of this Collective Bargaining Agreement," Article I, §5(a) of the parties' agreement [R. 12] (reproduced in Appendix A of Appellant's Opening Brief), and the Supreme Court has said that "the moving party should not be deprived of the arbitrator's

The logical extension of the Employer's argument in this case in support of the District Court's decision, is that if the Union *must* assert as a counterclaim even arbitrable grievances, a party to a contract calling for arbitration who would rather litigate than arbitrate need only file a suit contesting the arbitrability of the particular dispute or the applicability of the contract.[2] The other party would then be forced to the election of either asserting as a counterclaim all pending grievances which involved an interpretation of the contract, or run the risk of waiving those grievances under Rule 13(a).

We need go no further than the recent decision of this Court in *Los Angeles Paper Bag Co. v. Printing Specialties Union,* 345 F.2d 757 (9th Cir. 1965) for an excellent illustration of the ludicrous result the Employer's theory would have.

In *Los Angeles Paper Bag,* a suit was brought by a union to compel arbitration over the discharge of some employees for allegedly engaging in a strike. The employer counterclaimed for damages as a result of the alleged strike. With this Court's approval, the District Court ordered arbitration of the grievances to determine whether in fact there had been a strike, in the face of a contract clause expressly excluding from arbitration discipline imposed by the employer on persons who participate in strikes or work stoppages. In addition, the em-

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judgment, when it was his judgment and all that it connotes that was bargained for," *United Steelworkers v. American Mfg. Co.,* 363 U.S. at 568, 4 L.Ed.2d at 1407.

[2]Such a question, *i.e.*, arbitrability or applicability of the contract, must be answered by a court, see *John Wiley & Sons v. Livingston,* 376 U.S. 543, 546-47, 11 L.Ed.2d 898, 902-03 (1964), in the absence of a provision to the contrary, see *Desert Coca Cola Bottling Co. v. General Sales Drivers,* 335 F.2d 198, 199 (9th Cir. 1964).

ployer's counterclaim was stayed until the arbitrator decided if a strike had occurred.

Under the reasoning of the Employer in the instant case, the result in *Los Angeles Paper Bag* depended upon the fortuitous circumstances of whether the employer or the union initiated the court action, for if the employer had first sued for strike damages, the union would have been required to assert as a compulsory counterclaim for court adjudication its grievances over the employees' discharge.[3]

The District Court's ruling would turn *Los Angeles Paper Bag* on its head. Instead of giving way to the arbitral process, the District Court and the Employer would hypertechnically apply Rule 13(a) so as to erase a party's right to arbitrate whenever his opponent was so minded as to file a lawsuit—no mater how spurious—which was based on the same contract as that upon which the grievances were based.

The absurdity of such an emasculation of our National policy is patent and is answer enough to the Employer's arguments.

Respectfully submitted.

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[3]The agreement in *Los Angeles Paper Bag* did not require the employer to arbitrate its claim for damages. 345 F.2d at 760; *compare Atkinson v. Sinclair Ref. Co.*, 370 U.S. 238, 241, 8 L.Ed.2d 462-66 (1962), *with Drake Bakeries, Inc. v. Local 50, American Bakery Workers Union*, 370 U.S. 254, 258, 8 L.Ed.2d 474, 477-78 (1962). The same situation is applicable in the present case, where the Employer's suit against the Union was a non-arbitrable suit under section 302 of the LMRA [29 U.S.C. § 187].

Certificate.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

JULIUS REICH